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5

Tax Reform Option Paper No. V

Taxation of Transfer Payments and
Treatment of the Elderly

This paper discusses the tax treatment of payments which are transfers from the Government. For the most part under present law these are not taxed. This paper first presents the option of taxing virtually all transfer payments received by those with incomes above some specified level. Then the paper considers the various transfer payments individually and reviews each as to whether or not it should be taxed above some income level. The options reviewed individually are the taxation of social security and railroad retirement benefits; the taxation of unemployment benefits, the taxation of veterans' benefits; the taxation of black lung benefits; and the taxation of scholarship, fellowships, and GI benefits. The paper also considers the special benefits now available under the tax law for the elderly.

(1) General Treatment of Transfer Payments

Present Law.--Most Government transfer payments are not subject to tax. This was generally determined by administrative action at the time each transfer payment program was established. The principal Government transfer payments not taxed under the income tax are social security and railroad retirement payments, veterans' payments, workmen's compensation payments, military disability pensions, black lung payments, and various means tested payments such as welfare payments, housing allowances, food stamps, etc.

Proposal.--The Treasury does not support but some have suggested that for each dollar of AGI in excess of $20,000 for single individuals and $30,000 for married couples, 50 cents of public transfer payments (up to a maximum of two-thirds for payments financed in part by employee contributions) be taxable.

Revenue Estimate.--It is estimated that the taxation of all public transfer payments above the $20,000 or $30,000 levels (with phase ins), but subject to the one-third employee rule, would result in a revenue gain of $0.6 billion a year.

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

° This provides a comprehensive definition of income and capacity to pay. However, to the extent that the individuals have income below $20,000 ($30,000 for married couples), none of these payments would be subject to tax.

° This treats everyone with the same level of income the same, whether from it is from transfer payments or other sources (that is, assuming the income is above the $20,000 or $30,000 tax free levels).

° Under this type of proposal the after tax benefits of those most in need will not be reduced since the taxes on transfer payments only apply to those with income above $20,000 ($30,000 for married couples).

° Examples of cases where individuals may be receiving transfer payments yet have high levels of income are:

--unemployed individuals receiving tax-free unemployment insurance benefits married to individuals with high income levels.

--unemployed individuals who during part of the year receive substantial income but are also unemployed during a part of the year and drawing unemployment insurance.

--individuals with large investment income who are retired may receive tax-free social security benefits.

Con.--

° Any attempt to tax transfer payments generally will be perceived as imposing taxes on members of society who are the poorest and least able to pay. (This, of course, ignores the fact that those with incomes below $20,000 or $30,000 are unaffected).

- This approach will be viewed as a "foot-in-the-door" approach to tax all levels of transfer payments.

- The public attitude toward the taxation of transfer payments which relate to disability--including black lung and veterans' payments--is believed to be strongly adverse.

- It may be better to begin taxing transfer payments by approaching those where there is public acceptance of taxation above some starting income level. An example where the attitude may permit taxation is unemployment insurance benefits.

- Persons properly receiving means-tested payments such as welfare payments would only rarely be taxable. Therefore providing for their taxation would be a meaningless gesture.

Treasury Recommendation.--The Treasury does not believe this broad approach to public transfer payments can succeed. It believes that it would be much better to approach the taxation of transfer payments only in those areas where there is more an acceptance of the taxation of the payments. These considerations are set forth in the individual transfer payment discussion which follows. Therefore, Treasury

Tax all transfer payments above the specified level ______

Treat different transfer payments separately ______

Want to discuss further ______

Broad approach sounds best

(2) Social Security and Railroad Retirement Benefits

Present Law.--Under present law, monthly benefit payments received by social security and railroad retirement retirees are excluded from taxation. The exclusion is based upon a longstanding ruling of the Internal Revenue Service. The Railroad Retirement Act of 1974, however, restructured railroad retirement benefits into an underlying social security tier and pension tier (which is a government administered, industry pension plan); while employees and employers pay equal taxes for the "social security" tier, only railroad employers finance the second pension tier through a payroll tax of 9.5 percent.

Proposal.--The Treasury does not support it but social security and railroad retirement payments could be treated as taxable income with this treatment phased in to apply only where other income is $15,000 for single persons and $20,000 for married couples. For each dollar of other income above the specified amount, 50 cents of social security or railroad retirement income would be treated as taxable. However, to give tax recognition to employee contributions, the maximum amount of social security and comparable railroad retirement benefits that would be taxable would be two-thirds of the benefits received during a year (one-third is attributed to the employer and one-third is the tax-free interest income).

Railroad retirement pension benefits above the social security tier would be taxed in the same manner as private pension benefits.

Why not 20/30?

Alternative.--The income level at which social security or railroad retirement would be taxed could be raised to $25,000 if the individual is single or $30,000 if married.

Revenue Estimate.--The revenue gain is estimated at $600 million under the first alternative or $300 million for the higher income levels. The railroad retirement pension benefits above the social security tier which would be taxed involves a small revenue gain of less than $10 million.

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

- Less than 5 percent of all returns with social security income would be taxable on a portion of their benefits under the first alternative. With the higher starting tax levels, less than 2 percent would be taxable.
- Logically, to the extent social security and railroad retirement benefits are substitutes for private pensions or individual savings, they should be part of the tax base.
- Relief to the elderly may be appropriate, but there is little justification for it above certain income levels.

- The proposal would include these amounts in income only in the case of relatively high income aged.

- But for an historical anomaly, railroad retirement would be a private pension system. Railroad employers fund the railroad pension system, and treat their tax contributions as a normal deductible business expense. Pension tier benefits are tax-free for railroad employees, while all other private-sector employees pay taxes on their pension benefits.

Con.--

- Taxation of social security benefits politically is extremely difficult. Previous attempts to include social security benefits in the taxable income base have always failed. The concern is that the reaction to "taxing social security" (even if starting at a high income level) may be so negative as to have an adverse effect on the overall tax reform effort.

HEW Comment.--HEW supports in principle the taxation of certain social security benefits as long as other similar transfer payments are taxed. Their only important reservation is political: any such proposal may invite the Congress ? to reopen the question of expensive liberalizations of the earnings or "retirement" test in social security.

Domestic Policy Staff Comment.--The Policy Staff opposes the change in the treatment of railroad retirement pensions because it believes that railroad unions may have relied on this tax treatment in their negotiations. It may arouse a charge (admittedly incorrect) that this is starting to tax social security.

Treasury Recommendation.--In view of the likely adverse effect on the overall tax reform program, it is recommended that we forego any attempt to tax social security income, but do tax the portion of the railroad retirement representing the equivalent of a private pension.

Agree ______

Disagree ______

Want to discuss further ______

why not
tax all benefits
if income > $20/30 T
or > $15/20 T ?

(3) Unemployment Compensation Benefits

Present Law.--Under present law, unemployment compensation benefits paid under Government programs are not taxable.

Proposal.--Unemployment compensation benefits would be taxed in the case of an employee with other income above $15,000 for single individuals or $20,000 for married couples. For each dollar of other income above the threshold levels, 50 cents of the individual's unemployment compensation would be taxable.

Revenue Estimate.--The proposal would increase revenues by $275 million a year.

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

- Unemployment compensation, since it is a replacement for wages during the period of unemployment, appropriately should be taxable.
- Nontaxation of unemployment compensation creates a disincentive to work. This is particularly true if the beneficiary has property income or is married to a spouse with substantial earnings.
- Frequently, individuals with relatively high incomes who work during a portion of the year receive unemployment compensation benefits for the portion of the year during which they are unemployed.
- Unemployment compensation can be distinguished from payments such as workmen's compensation, black lung benefits, and veterans' benefits which basically are compensation for disability.

Con.--

- The argument against taxing the benefits is that unemployment benefits represent relief in a hardship situation.

° Some believe that taxing unemployment benefits would require provisions for a higher level of benefits.

Department of Labor Comment.--The DOL believes that the $15,000 and $20,000 income limits should be indexed so that an increasing proportion of unemployment payments will not be taxed in the future as prices rise.

Treasury and CEA Comment.--There is no more reason to index this particular item than many others in the tax law.

Treasury Recommendations.--Unemployment compensation benefits should be treated as taxable income above threshold levels of $20,000 of other income for married couples and $15,000 for single individuals, with a phase in above those levels.

Tax benefits above specified level ______

Do not tax ______

Want to discuss further ______

Tax all xfer payments if inc > "x"? (all or 50%)

(4) Veterans' Benefits

Present Law.--Amounts received by veterans as payments from the Veterans' Administration are excludable from taxation. Military disability pensions are also tax exempt.

Proposal.--The Treasury does not recommend taxing veterans' payments or limiting disability pensions. However, if this were to be done the benefits might be taxable where the veteran had over $15,000 of other income if single or $20,000 if married. The veterans' benefits in the case of those with incomes above these levels would be taxed to the extent of 50 cents for each $1 of other income above the specified level. (GI bill benefits are treated as scholarships and are discussed below.)

Revenue Estimate.--The proposal would increase revenue by $221 million a year.

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

- Veterans' benefits and military disability pensions are a tax-free source of income which are worth more the higher the taxpayer's marginal tax rate. It is only fair to include these items in taxable income in the case of individuals who are relatively well off.

Con.--

- Veterans' payments are paid for a disability (some service connected and others not) or death. As long as workmen's compensation payments are excluded from tax it appears appropriate also to exclude veterans' payments.

- The taxation of veterans' benefits and military disability pensions will be very difficult to accomplish politically. There is the danger that the reaction to taxing these benefits at any level would be so negative among veterans' groups as to adversely affect the entire program.

Treasury Recommendation.--The Treasury recommends no change in present law on veterans' benefits or any type of disability payment.

Same as above

Tax payments ______

Do not tax payments ______

Want to discuss further ______

(5) Black Lung Benefits

Present Law.--The Internal Revenue Service has ruled that payments made to coal miners as compensation for black lung disease are not includable in income on the grounds that they are amounts received as compensation for personal injuries or sickness under workmen's compensation. As a practical matter, such payments are made to any miner after long years of service in the mines with little or no proof required of actual disease.

Proposal.--Taxing black lung payments is not proposed by the Treasury. Black lung benefits, however, could be taxed as received above threshold levels of $20,000 of adjusted gross income (other than the benefits involved) for married couples and $15,000 for single individuals. Above the threshold levels, 50 cents of black lung benefits could be taxable for each dollar of adjusted gross income above the threshold level.

Revenue Estimate.--The increase in revenue would be negligible.

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

- Since no proof of disability is required, these payments can be distinguished from workmen's compensation payments.
- Since these payments and most workmen's compensation payments are a substitute for earnings lost they both should conceptually be viewed as taxable income.

Con.--

- So long as the basic exemption for workmen's compensation benefits is retained, it seems inappropriate to tax black lung benefits, even though in some instances benefits are paid to persons without evidence that the recipient actually has the disease.
- The proposal would reach very few individuals, since almost all recipients of black lung benefits have incomes below the proposed threshold levels.
- Taxation of the benefits would be politically difficult because of the sympathy for the low-income miner.

Treasury Recommendation.--No change should be made in the present treatment of black lung benefits which are not now subject to tax.

Same as above

Tax payments ______

Do not tax payments ______

Want to discuss further ______

(6) Scholarships, Fellowships, and GI Bill Benefits

Present Law.--Under present law, amounts received by an individual as a scholarship, fellowship, or benefit under the GI bill are tax exempt. The tax-exempt amounts received by an individual who is not a candidate for a degree are limited to $300 per month for a maximum of 36 months. The tax-exempt amounts include compensation for personal living expenses by way of scholarship or fellowship as well as amounts to cover tuition and fees.

Proposal.--The present exclusion for scholarships (including national health scholarships), fellowships, and GI bill benefits would be limited to amounts allowed for tuition and fees. Tuition and fees that under present law are taxed as compensation would continue to be so treated except national health scholarships and similar Government programs which would be exempt.

Revenue Estimate.--The proposed elimination of exclusion for scholarships and fellowship benefits other than tuition and fees would increase revenues by $170 million a year.

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

° Limiting the exclusion to tuition and fees is all that is necessary to provide equal treatment between scholarship recipients and students at free and low-cost schools.

° The elimination of the broader exclusion would end extensive litigation as to whether amounts received (e.g., by medical residents) constitute a scholarship or compensation for services.

° The reduction of the exclusion would provide equal treatment among taxpayers by taxing amounts used for living expenses regardless of source.

° A taxpayer who had no source of income for his living expenses other than the scholarship or fellowship would be likely to be nontaxable in any event because of the personal credit and standard deduction.

° While the income level of the students who would have some tax under this program is relatively low, quite often these students come from families with relatively high income.

° Frequently high-income taxpayers, such as professors, are able to receive compensation or fellowships while doing summer work at another institution and to exclude $300 per month from their income.

Con.--

° Many will favor the present exclusion on the grounds that it is a desirable subsidy for education.

° Removal of the exclusions for GI benefits will be objected to by many as a cutback in veterans' benefits.

V.A. Comment.--The V.A. does not favor the taxation of GI bill benefits. They argue that it will increase pressure to provide a more costly separate tuition allowance, in addition to the present cash allowances which may be spent as the veteran chooses.

Domestic Policy Staff Comment.--The Policy Staff opposes this recommendation because 90 percent of this preference goes to individuals with incomes below $10,000.

Treasury Comment.--It is likely that many of the students receiving fellowships and many with scholarhips come from families with middle or high incomes.

Treasury Recommendation.--Amounts received by way of scholarship, fellowship, or GI bill benefits should be includable in taxable income except to the extent that they represent allowances for tuition and fees.

Agree ______

Same as above ?

Disagree ______

Want to discuss further ______

(7) Credit for the Elderly

Present Law.--An individual who is over age 65 may take a credit of 15 percent of $2,500 of income, if single, or of $3,750, if married. The $2,500 and $3,750 amounts, however, are reduced by social security, railroad retirement benefits, and other tax-free pensions or annuities. The income base for the credit is also phased out for higher income taxpayers. It is reduced by one-half of the taxpayer's income in excess of $7,500, if single, or of $10,000, if married.

There is a special credit for persons under age 65 who receive retirement pensions under governmental retirement systems. This credit is similar to the credit for taxpayers who have reached age 65. However, there is no phase out based on income. Instead, the $2,500 and $3,750 income bases are reduced by earned income in excess of $900 if the individual is under age 62. If he is 62 or over the reductions are 50 percent of earned income from $1,200-$1,700 and 100 percent of income over $1,700.

Proposal.--The retirement income credit for public employees under age 65 would be repealed entirely.

The credit for the elderly would be based on income of $3,000 (instead of $2,500) for single taxpayers or $4,500 (instead of $3,750) for married taxpayers. This would be reduced in the same manner as present law, for social security, railroad retirement, and similar benefits. It would continue to be phased out for income over $7,500 for single taxpayers and $10,000 for married taxpayers.

Revenue Estimate.--The proposal will decrease revenues by about $11 million a year.

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

- The elimination of the retirement income credit for public employees under age 65 will be a substantial simplification of the law.
- The elimination of the credit for public employees also would be a substantial improvement in tax equity since it will treat Government retirees the same as private industry retirees.
- The increase in the income level on which the general elderly credit is based from $2,500 for single individuals to $3,000 and from $3,750 for married couples to $4,500 is justified by the rise in social security levels.

Con.--

- Government retirees below age 65 who are already receiving benefits will consider it unfair to tax them.

Treasury Recommendation.--The retirement income credit should be repealed for public employees under the age of 65. The limitation on the income eligible for the credit for the elderly should be increased to $3,000 for single individuals and $4,500 for married couples.

Repeal special credit for government retirees under age 65 ______

Do not repeal this credit ______

Want to discuss further ______

other general income limit applicable?

Increase base of credit for those over age 65 ______

Do not increase base of credit ______

Want to discuss further ______

6

THE WHITE HOUSE

WASHINGTON

September 23, 1977

MEMORANDUM FOR: THE PRESIDENT

FROM: STU EIZENSTAT Stu
BOB GINSBURG

SUBJECT: Option Paper No. VI: Employee Fringe Benefits

1. Areas of Agreement. We support Treasury's recommendations to:

(a) limit the exemption (from the income of employees) for employer-paid premiums on group term life insurance coverage to those paid on the first $25,000 of coverage (down from $50,000 under present law); ok

(b) make a series of changes in provisions affecting group term life insurance, medical and disability insurance, retirement plans, and employee death benefits for the general purpose of removing those aspects of these items which permit discrimination in favor of corporate officers and high bracket taxpayers generally; and ok

(c) deny the deduction of the expense of attending foreign conventions unless it is reasonable for the convention to be held outside the United States and, for such conventions, increase the allowable deduction from 100% of the Government per diem to 125%. ok

2. Group Legal Insurance. Treasury proposes to make employer-paid group legal insurance taxable to the employees. From a tax reform viewpoint, Treasury is correct in arguing that provision of legal services is a form of income and that this provision could become an unfortunate model for exempting other employer-paid expenses from tax. We are concerned, however, with this proposal because: group legal insurance tends to help correct the maldistribution of legal services for low and middle income persons; this insurance is not essentially different from tax-exempt employer-paid medical services; and this proposal would be particularly provocative

to the unions (the UAW in particular) which just succeeded last year in getting legislation passed exempting these benefits from taxable income.

3. Travel and Entertainment Expenses. Treasury proposes to eliminate business deductions for entertainment facilities such as yachts, club dues, etc. We agree. However, Treasury proposes to leave untouched deductions for theater and sporting event tickets, golf fees, and first-class airfare. We do not see the distinction between these symbols of "expense account" living and club dues. We recommend that deductions be eliminated for theater and sporting event tickets and golf fees and that the deduction for airfare be limited to economy or coach class (this should apply to corporate jets as well as commercial flights, if technically possible):

-- We think that the limited Treasury proposal is inconsistent with your strong statements on "expense account" living. The general public cares more about expense account "loopholes" than any other preferences in the tax code. Our proposals in this area will reflect on the credibility of our entire tax reform program.

-- The general public will never understand why they should continue to subsidize 50% of the cost of tickets and first-class travel. During the campaign you argued against first-class airfares as a tax break for the wealthy.

-- All the reasons for eliminating the deduction for club dues apply to these items as well (and perhaps even more so to tickets).

-- Although not nearly as important as the principle here, the revenue involved is not insignificant, possibly amounting to $250 million per year.

4. Business Meals. Treasury proposes to disallow only 50% of the cost of business meals. Again, we do not think that the average taxpayers should have to subsidize 50% of the cost of lavish dining. All the reasons mentioned above and the public's concern over perceived abuses come into play here as well. We recommend that deductions for business meals be limited to the lesser of a flat dollar amount per meal (e.g., $15) or 50% of the cost of a meal; if you prefer a simpler standard, we would recommend just a flat dollar limitation per meal.

Tax Reform Option Paper No. VI

Employee Fringe Benefits

This memorandum sets forth specific tax reform proposals affecting employee fringe benefits. The proposals described below pertain to (1) group term life insurance, (2) medical and disability plans, (3) group legal insurance, (4) retirement programs, (5) employee death benefits, and (6) travel and entertainment.

(1) Group Term Life Insurance

Present Law.--Employer-paid premiums on the first $50,000 of group term life insurance coverage are tax free to employees. The statutory limit was imposed in 1964. Previously an unlimited exclusion was allowed by the IRS. Employer financed group term life plans (unlike qualified pension plans) may discriminate in favor of higher paid employees by excluding lower paid employees from the plan or by providing a disproportionately higher benefit for the highly paid.

Proposal.--The $50,000 limit on coverage would be reduced to $25,000. The reduced exclusion would only apply to plans whose coverage and benefits do not discriminate in favor of officers, shareholders, or higher paid employees.

Revenue Effect.--The reduction in the limit to $25,000 would increase revenues by $165 million a year.

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

- Compensation ought to be taxed in whatever form provided. However, relatively small amounts should not be included in income if equity is offset by administrative difficulties.

- A tax break may be justified if it helps to secure coverage for rank and file workers.

Con.--

- Questions may be raised as to why this exclusion is not reduced further or removed entirely. (The $25,000 level covers most blue collar employees.) At age 60 the annual exclusion from income on $25,000 of insurance is $489.

Treasury Recommendations.--The exemption of group term life insurance should be reduced from $50,000 of coverage to insurance protection of $25,000.

Agree ______

Disagree ______

Want to discuss it further ______

The reduced exemption should be allowed only for non-discriminatory plans. ?

Agree ______

Disagree ______

Want to discuss it further ______

(2) Medical and Disability Insurance

Present Law.--If an individual purchases medical or disability insurance the premiums for disability insurance are not deductible and those for medical insurance may be deducted only within the limits applicable to the medical expense deduction (which we propose to make more stringent). The benefits received are not taxable.

On the other hand, if the employer establishes a program neither the premiums nor the benefits (except for disability benefits in excess of specified limits) are taxable. The program need not cover all workers and can discriminate in favor of officers or higher paid employees.

Proposal.--The tax exemption for premiums paid and benefits received under employer established health, accident and disability plans would apply only if the plan did not discriminate in favor of officers, shareholders, and higher paid employees.

Revenue Effect.--It is estimated that this proposal would increase tax revenues by $30 million a year.

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

- Present law favors employer-sponsored insurance programs over individually purchased policies. This makes sense only to the extent that it gives assurance of wide coverage, particularly for those least likely to secure their own protection.

- Nondiscrimination standards now apply to pension programs and group legal service plans and are being recommended here for group term life insurance.

- Basic changes in this area (apart from nondiscrimination) need to await action in the national health insurance program.

Con.--

- The exclusion of payments for medical and disability care from taxable income is a major tax expenditure, amounting to about $5 billion in terms of revenue. (Its omission from a comprehensive tax reform bill would appear to be justified only on the grounds that a national health insurance program has yet to be developed.)

Treasury Recommendation.--A nondiscrimination standard should be added for employer sponsored health and disability plans.

Why exempt at all?

Agree ______

Disagree ______

Want to discuss further ______

(3) Group Legal Insurance

Present Law.--The Tax Reform Act of 1976 provided that contributions and benefits received under a group legal services plan are not taxable.

Proposal.--The tax preference for employer financed prepaid legal insurance enacted in 1976 would be repealed.

Revenue Estimate.--It is estimated that this provision would increase tax revenues by $40 million a year.

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

- Generally, it does not appear desirable to provide an exclusion for employer provided benefits where a deduction is not allowed an individual for the same expenses.

- If government help in providing legal services is needed, the tax system is not the most equitable or efficient means of providing it.

- This provision adopted just last year should be repealed before it becomes a model for other exclusions which are sure to be proposed if this is left in the law. Life and health insurance exclusions are not a precedent. Benefits from these are more basic and, in any event, the exclusion grew out of earlier administrative exemptions originating before the income tax applied so widely.

Con.--

- There will be serious objections to the inclusion of the amounts paid for these expenses in income. Objections will come from the bar groups and from the unions (the UAW recently announced a program of this type with Chrysler).

- Some believe that since businesses can claim deductions for legal fees as business expenses, equity requires deductions for those incurring legal fees for personal purposes. (This concept, even if accepted, would appear to lead to the deduction of legal expenses whether or not paid by the employer; however, business legal expense relates to the earning of income, which is not true in the case of personal legal expenses.)

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Domestic Policy Staff Comment.--The Policy Staff recommends that the exclusion for group legal service plans should be retained because it helps low and middle income persons get adequate legal services and is similar to tax exempt medical services.

Treasury and CEA Comment.--In general, compensation ought to be taxed in whatever form it occurs. Since group legal insurance has not yet established itself as a widespread tax preference, it should be removed as soon as possible.

Treasury Recommendation.--The exemption for group legal service plans should be repealed.

Repeal exclusion ______

Retain exclusion ______

Want to discuss further ______

(4) Qualified Retirement Plans

Present Law.--"Qualified" pension plans (those that do not discriminate in favor of higher paid employees) receive preferential tax treatment: (1) no tax is imposed on the amount set aside for an employee and (2) the tax on the earnings so set aside is postponed until the employee retires and receives these amounts as pension benefits. In determining whether a pension plan is discriminatory (i.e., adverse to lower paid employees) present law allows the amount an individual would receive under social secuirty to be taken into account.

A "defined benefit" pension plan provides that an individual will receive a specified benefit upon retirement; and a "defined contribution" plan provides that a specified amount will be set aside each year and that upon retirement the employee will receive this amount plus the earnings on it. Presently, the maximum annual benefit under a defined benefit plan is $75,000 plus a cost of living adjustment (which currently has brought this limit up to more than $84,000). Under a defined contribution plan no more than $25,000, adjusted for a cost of living factor, may be set aside for an employee in any year. Where an employee is covered by both a defined benefit and defined contribution plan, the maximum benefit may not exceed 140 percent of the two maximums taken together.

Seems very high

?

In addition to qualified pension plans, present law also allows amounts to be set aside for retirement purposes by the self-employed (Keogh plans) and by shareholders of subchapter S corporations (generally treated like partnerships). Certain nondiscrimination requirements also apply in the case of these businesses. The maximum amounts for which a deduction may be taken under these plans is 15 percent of compensation, or $7,500 a year, whichever is the lower.

Seems hi enough for all

Synchronize all this

Proposal.--A series of changes would be made. First, the $7,500 annual limitation on contributions to qualified plans for self-employed persons would be extended to shareholders with a 10 percent or greater interest in a corporation.

Second, the maximum limitation on defined benefit pension plans would be reduced to a $60,000 per year benefit with no cost of living adjustment, and the amount which could be contributed for any employee under a defined contribution plan would be limited to $15,000 a year with no cost of living adjustment.

Still seems high

Third, where an employee is covered by both a defined benefit and a defined contribution plan, the maximum benefits for which he would be eligible under two plans could not exceed the maximum (or its equivalent) allowed under either plan alone.

Fourth, the plan would no longer be permitted to entirely exclude employees all of whose wages are covered by the social security system. An employer could provide a greater benefit as a percentage of his employees' pay over the social security wage base if he provides a benefit for all employees at a specified lower percentage of their pay which is included in the social security wage base.

Revenue Estimate.--It is estimated that this proposal would increase tax revenues by $10 million a year.

Discussion of the Issues.--The primary reasons for and against these proposals are:

Pro.--

- Consistent treatment of owners of businesses, whether incorporated or not, will stop the trend towards incorporating solely for tax reasons, especially by professionals with six figure incomes. The eventual goal would be to substantially reduce the overall limit and make it consistent for all persons, owners or not. This would be difficult to accomplish, but if the proposed limits are adopted we will have taken a major step toward this goal.

Why not go all the way? (at least in stages)

° Tax preference for retirement saving assumes social security alone will not sufficiently provide for the elderly and further government aid is desirable. Allowing the inclusion of higher paid persons in the tax-favored plan helps assure that employers will establish plans which will aid rank and file workers. However, it is difficult to justify a tax preference to provide retirement income of as much as $80,000 to $100,000 per year for employers or management personnel. (The proposed limits will still allow a benefit of at least $60,000 per year.)

Too much

° Special tax treatment of qualified plans is justified on the grounds that social security alone does not provide adequately for retirement. In view of this, it seems inappropriate to permit the private system to squeeze out completely lower paid employees on the grounds they are treated adequately by social security. On the other hand, it appears logical to permit an employer whose plan, for the lower paid, in combination with social security, tends to provide replacement of pre-retirement earnings, to move toward similar replacement at higher levels without necessarily increasing retirement income at lower levels to the same extent.

Con.--

° Pension reform was enacted in 1974. It is too early to reopen questions in this area.

Treasury Recommendations.--Deductible contributions for 10 percent or larger shareholders of corporations should be limited to the equivalent of the $7,500 limit now imposed on partners and shareholders of subchapter S corporations.

Agree ______

Disagree ______

Want to discuss further ______

The limit on annual benefits from qualified pension plans should be reduced from $75,000 to $60,000 and the annual contribution to defined contribution plans reduced from $25,000 to $15,000. The maximum benefit for those with both defined benefits and defined contribution plans could not exceed 100 percent of the maximum under either. In addition, the cost of living adjustment on these limitations should be removed.

Seems too hi

Agree ______

Disagree ______

Want to discuss further ______

"Integration" of private retirement plans with social security should be allowed only if some minimum benefits are provided for lower paid employees.

Agree ______

Disagree ______

Want to discuss further ______

(5) Employee Death Benefits

Present Law.--There is a statutory exclusion for $5,000 of amounts paid by an employer by reason of death of the employee. In addition, insurance proceeds received at death are fully tax exempt.

Proposal.--The $5,000 death benefit exclusion would be repealed.

Revenue Estimate.--It is estimated that this proposal would increase tax revenues by $30 million a year.

Discussion of the Issues.--The primary reasons for and against the proposal are:

Pro.--

- The principal beneficiaries of tax exclusions are high bracket individuals.

- These payments are in the nature of deferred wages and as a result it would appear that they should be taxed.

Con.--

- Some will view the requirement that any amount be included in income of an heir upon the death of an individual as undesirable.

- It will be noted that insurance proceeds payable upon death are not includable in the income of the heir.

Treasury Recommendation.--The $5,000 death benefit exclusion should be eliminated.

Agree ______

Disagree ______

Want to discuss further ______

(6) Travel and Entertainment

Present Law.--Prior to 1962, entertainment expenses were deductible if they met the minimal standard that they were appropriate and helpful for the development of the taxpayer's business. Taxpayers who could not substantiate specific expenditures then were allowed a deduction on the basis of estimates.

Begining in 1962, Congress required taxpayers to submit evidence of particular expenditures and imposed some restrictions on the conditions for allowance of the deduction. However, cost of entertainment preceding or following a substantial business discussion continues to be deductible. If the entertainment event is not in conjunction with a separate business discussion then there must be a showing that the taxpayer reasonably sought a business advantage from the entertainment event itself (e.g., from a discussion or product display) beyond the mere development of goodwill. Club dues and the cost of facilities such as yachts are deductible only in the proportion that they are used to obtain a specific business advantage from the activity, not merely because they are used for entertainment following or preceding a business discussion.

In 1976, Congress provided that business expense deductions for attending foreign conventions could be taken for no more than two conventions per year. Second, deductions are not allowed unless the individual attends approximately two-thirds of the scheduled business activities of the convention, and these activities must cover most of the time the individual was not in transit to or from the site. The time spent by the individual at the convention sessions must be verified (under oath) by a convention official. Third, the subsistence expenses for which deductions are taken may not exceed the per diem rates which would be available for government trips to the same locations by Federal employees. Fourth, the deduction for transportation expenses outside of the United States may not exceed the lowest coach, or economy, rate charge by a commercial airline.

Proposal for Entertainment.--The Treasury recommends that entertainment deductions:

(1) be totally disallowed with respect to entertainment facilities (yachts, hunting lodges, club dues) and

(2) be denied to the extent of 50 percent in the case of business meal expenses otherwise allowable as a business deduction.

Alternatives.--Limitations on these deductions proposed by others would:

(1) deny any deduction for costs involving theater tickets, sporting events, golf fees, and the like, ok

(2) in the case of meals, instead of disallowing half, disallow any amount taken over $15 per person per meal~~, and~~ or ~~at~~ 50%, the smaller

(3) in the case of business travel, limiting the deduction for business travel in the case of air fares to the cost of coach or economy class fares. ok

Proposal for Conventions.--The Treasury recommends that no deduction be allowed for expenses incurred to attend a convention, seminar, or other meeting held outside of the United States and possessions unless it is reasonable for the meeting to be held outside of the United States because of the composition of the membership or the specific purposes of the organization. For qualified foreign conventions the deduction allowed for subsistence would not exceed 125 percent of the government per diem for the area.

Revenue Estimate.--It is estimated that this proposal would increase tax revenues by $750 million a year at 1976 levels of income. The three other suggestions advocated by some are believed to increase this estimate by about $250 million. It should be understood that it is difficult to reach estimates in these areas because of the absence of concrete data. Therefore, these estimates should be viewed as approximations.

Discussion of the Issues.--The primary reasons for and against this proposal are:

Entertainment Deduction

Pro.--

° Entertainment to a substantial extent is a personal consumption item, and allowing a deduction without taxation to participants is equivalent to permitting a portion of the compensation to be tax free. Those not covered by "expense account living" are seriously discriminated against by the present treatment.

° The present treatment of entertainment expenses artifically encourages individuals to favor entertainment over other forms of consumption.

° It will add to business efficiency if goods and services are promoted on a basis other than who can provide the best entertainment.

° Business will be able to reduce its reliance on entertainment particularly since all companies face the loss of deduction.

° The one-half disallowance for meals in effect disallows only the cost of the individual's own meal where two are involved (the individual would presumably have to pay the cost of his own meal in the absence of the business luncheon). Where larger numbers are involved at the luncheon, the probability of the luncheon being a truly business meal tends to decrease as the number increases.

Con.--

- The proposed limitations on entertainment expenses in many cases will amount to a denial of a deduction for ordinary and necessary business expenses.

- Restaurant organizations and their employees will create strong political pressures against these limitations on entertainment deductions.

- Denying a deduction for first class air fare implies that in the case of all business expenses strict economy rules should be followed.

Foreign Conventions

Pro.--

- Foreign conventions may serve a valid business purpose but involve a high potential for deducting the cost of a vacation at the expense of taxpayers generally. The rules of the 1976 Act curbed some abuses but still permitted deductions for two conventions per year.

- The proposed new rules eliminate deductions for foreign conventions except where there is a valid reason for holding it abroad.

- Most of the restrictions on the present foreign convention rules which are generally viewed as burdensome would be repealed.

Con.--

- Neighboring countries including Canada, Mexico, and some of the Caribbean nations believe the limitations on foreign conventions have seriously injured the tourist business in their countries and have requested relief. (It may be possible to provide relief by tax treaty and obtain some objectives sought by the United States; for example, exchange of information in the case of Bahamas.)

State Department Comment.--The State Department would support proposals to limit the normal deductions for foreign conventions if a foreign site of a convention is reasonable because of the organization's large foreign membership or other specific reasons for holding the meeting at a certain site and would favor raising the daily expense allowance. In its view, however, these restrictions should apply to both domestic and foreign conventions.

Domestic Policy Staff Comment.--The Policy Staff believes that deductions for business meals should be limited to a flat dollar amount per person per meal (or one-half the cost of the meals, whichever is the lesser), that there should be no deduction for tickets to sporting events, theatres, etc., and that there should be no deduction for air fares other than economy or coach fares.

Treasury Recommendations.--The deduction for entertainment facilities and dues should be disallowed.

Agree ✓

Disagree ______

Want to discuss further ______

The Treasury does not recommend any further limiting of deductions for cost of tickets to entertainment (sports, theatre, symphony, etc.).

Deny all deduction for these tickets ______

Do not change treatment in present law ______

Want to discuss further ______

The Treasury recommends that the deduction for one-half cost of otherwise allowable business meals should be disallowed.

Lesser of two

Limit deduction to one-half of meals ______

Limit deduction to $15 (or some other amount) per person per meal ______

Do neither of the above ______

Want to discuss further ______

The Treasury does not support a proposal to limit travel expense to coach or economy air fares.

Limit travel to economy or coach fare cost ______ •

Do not limit travel to economy or coach fare cost ______

Want to discuss further ______

The Treasury recommends that the deduction for foreign conventions should be disallowed unless it is reasonable for the meeting to be held outside the United States and possessions. The deductions should be limited to 125 percent Government per diem (now limited to 100 percent).

Agree ______ •

Disagree ______

Want to discuss further ______

7

THE WHITE HOUSE

WASHINGTON

September 23, 1977

MEMORANDUM FOR: THE PRESIDENT

FROM: STU EIZENSTAT Stu
BOB GINSBURG

SUBJECT: Option Paper No. VII: Tax Treatment of Interest

1. Areas of Agreement. We support Treasury's recommendations to:

   (a) provide for withholding on interest and dividend payments;

   (b) provide state and local governments with a taxable bond option in addition to the existing conventional tax-exempt municipal bonds; and

   (c) eliminate the tax exemption for the interest on certain industrial development bonds.

2. Interest Buildup on Life Insurance and Annuity Contracts. Treasury originally recommended to you that the interest earned on the savings element of cash value life insurance and on annuity contracts (issued after the date of our tax reform statute) be taxed to the policyholders. Treasury has withdrawn that recommendation in the face of strong industry opposition and the concern that policyholders might join with insurance agents to oppose this measure. (Of course, the proposal would only apply to future insurance policies.) Treasury also notes that interest on an insurance policy, unlike savings account interest, cannot be withdrawn without borrowing against or cancelling the policy.

   The other side of the argument, as the option paper indicates, is that as a matter of equity this interest is the same as any other interest and persons who save via cash value insurance policies should pay no less tax than those who put their money in a savings bank. The tax-exempt status of this form of saving gives life insurance companies a competitive advantage over commercial banks and savings and loan associations. In addition, elimination of the capital gains preference may make insurance and annuity contracts the new tax shelter of the future for high bracket taxpayers if we do not subject the interest element to tax.

Accordingly, we recommend that the interest buildup be brought into the tax base for all future insurance and annuity contracts. A middle ground (which may not be technically feasible) would be to tax the interest buildup only on insurance or annuity coverage in excess of $100,000 per person. If you are unwilling to recommend fully taxing the interest buildup, this middle ground would be a less controversial -- but still meaningful -- reform.

Tax Reform Option Paper No. VII

Tax Treatment of Interest

This memorandum presents tax reform proposals for withholding tax on taxable interest and dividend payments, for the taxation of the presently nontaxed interest buildup of life insurance and annuity contracts, for an option to State and local governments to issue bonds bearing taxable interest and for the elimination of tax exemption for certain industrial development bonds.

Withholding on Interest

Present Law.--No tax is withheld on payments of interest to domestic taxpayers, although tax is withheld from wage recipients. Payors of certain categories of interest--principally bank accounts and registered bonds--are required to report to the Government and the interest recipient the amount of interest paid during the year.

Proposal.--Payors of taxable interest would be required to withhold 20 percent of the interest payments they would otherwise make and report to the government and to the interest recipient the amount of interest paid and tax withheld. Individuals who reasonably believe they will owe no tax and exempt organizations may file exemption certificates with the interest payor and avoid withholding. Withholding would also be implemented with respect to dividends. (A discussion of dividend withholding is contained in the section on relief from double taxation in Option Paper No. IX.)

Revenue Estimate.--Withholding would increase annual tax collections by $1.4 billion at 1976 income levels.

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

- Interest income is essentially the same as income from wages, on which tax is withheld. Recipients of interest should pay their tax with no less certainty than wage earners, and just as promptly.

° There could be \$8 billion or more of taxable interest received by taxpayers not being reported as income. This results in a loss of perhaps \$1.4 billion of tax.

° Large continued tax avoidance diminishes public respect for the tax system, could jeopardize our voluntary system of compliance and is patently unfair to persons who must, as a result, bear a larger share of the tax burden.

° Withholding at a 20 percent rate will not result in significant hardship for persons in rate brackets lower than 20 percent. Under the proposal, a person who reasonably believes he will owe no tax may file an exemption certificate and avoid withholding. Even persons having some income subject to tax will not be caused undue hardship because they will either have substantial income producing assets or miniscule overwithholding.

° Congress in 1962 provided for information reporting on interest on a trial basis to close the non-reporting gap. Since the gap has not been closed it is appropriate to renew the request for withholding.

<u>Con.</u> --

° The banks, mutual savings banks, and savings and loan associations based on past experience can be expected to strongly resist provision for withholding on bank interest.

° It is argued that withholding would impose an undue administrative burden on financial institutions and other interest payors. (This burden would be minimized by advances in automatic data processing and, to the extent possible, by tailoring the withholding system to dovetail with the reporting requirements of present law.)

° It is argued that withholding would further complicate preparation of individual income tax returns. (The procedure for including interest in income and claiming a credit for the tax withheld is no more complicated than the present system for withholding on wages.)

° It is argued that the problem of underreporting of interest income can be solved without a withholding system by expanding the reporting requirements of existing law to cover interest paid on government obligations and by increasing audit and enforcement procedures. However, while some nonreporting is deliberate tax evasion, much of it is due to inadvertence, forgetfulness and failure to keep records, particularly by taxpayers who receive a small portion of their income as interest. It is impracticable and inefficient to rely on information documents combined with audit procedures to verify and to follow up on millions of interest transactions, many of which are quite small.

Treasury Recommendation.--Tax should be withheld on payments of interest at a 20 percent rate.

Agree ______

Disagree ______

Want to discuss further ______

Taxation of Interest Buildup of Life Insurance and Annuity Contracts

Present Law.--The interest income on the savings element of cash value insurance is not taxed to the policyholder while it is accumulating or when paid to the beneficiary at death. Nor is it at any time taxed to the life insurance company. Similarly, the interest earned on the investment by a life insurance company of premiums received under an annuity contract is not taxable as it accumulates, but in this case these earnings are taxed to the annuitant when the annuity payments commence.

Proposal.--The Treasury does not recommend taxing currently the interest earned on the savings element of cash value life insurance or on annuity contracts. (The amount includable in a policyholder's income each year could be equal to the annual increase in the cash surrender value of his policy less the annual net premium allocable to the cash surrender value. The applicable portion of the annual net premium could be calculated from a standard table prescribed by the IRS.) The insurance company could be required to withhold 20 percent of the amount taxable to its policyholders and report to the government and each policyholder the amount of interest includable in the policyholder's income and the amount of tax withheld.

Phase in of Change.--To avoid retroactivity, the proposal could apply to policies and contracts issued after the effective date of the legislation.

Revenue Estimate.--The proposal would raise very little revenue at first since the new rules would apply only to new policies. When fully effective the annual revenue derived from taxing the interest buildup in insurance and annuities would be $1.1 billion at 1976 income levels.

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

- The interest element of cash value insurance and annuity contracts is, as a matter of equity, much the same as earnings from other forms of saving. Moreover, policyholders can reach the funds by cashing in policies or borrowing on them. Persons who save by investing in cash value insurance and annuity contracts should pay no less tax [less] than persons who choose other forms of saving.

- If the interest element of cash value insurance and annuity contracts remains exempt from tax, investment in these forms of insurance will be especially advantageous for persons with large incomes subject to high marginal tax rates. This will be increasingly true as most other forms of income are made taxable.

- The tax free interest element in life insurance policies is one of the primary sales pitches of life insurance agents. It is undesirable from the standpoint of the tax system that statements of this type can be made.

- Some say that persons should be encouraged to purchase cash value insurance since it provides benefits in the event of the early death of the insured or savings if the insured does not die prematurely. However, persons who carry term insurance receive little benefit from this tax exemption.

- If the interest element of cash value insurance and annuity contracts should remain free of tax, life insurance companies will increase their competitive advantage relative to other forms of savings. This diverts savings into cash value insurance and annuities and away from commercial banks, savings and loan associations, etc. which are being taxed more heavily. Also insurance savings will at death become virtually the only form of savings free of tax.

Con.--

- The insurance companies and insurance agents throughout the country can be expected to resist strongly the taxation of the interest element in life insurance policies.

- Interest on life insurance savings differs from interest on savings accounts in that the policyholder does not have access to the interest unless he borrows against the policy or surrenders the policy.

- Taxing the interest element of life insurance and annuity contracts to policyholders will impose an administrative burden on life insurance companies. (This burden should not be substantial since life insurance companies are in the business of making mathematical calculations, maintain staffs of trained mathematicians and make extensive use of computers. Life insurance companies send policyholders and annuitants regular premium notices and reporting the amount of income taxable to them and the amount of tax withheld should not present difficulties.)

- Taxing policyholders on the interest element of cash value insurance would further complicate the preparation of individual income tax returns. (For policyholders the procedure for taxing them on this interest element is the same as that for withholding on wages.)

- Insurance agents will strongly object to this change because the nontaxed status of this income is one of the strongest selling points to policyholders. The agents view this as a desired subsidy to encourage the purchase of insurance policies which serves an important social purpose.

° The proposed system for taxing policyholders on the interest element of cash value insurance will not measure precisely the interest element on cash value policies issued by all companies. (However, the standard table prescribed by the IRS can assure that policyholders will not be taxed on more than their share of investment interest.)

Domestic Policy Staff and CEA Comment.--The Policy Staff and CEA favor taxing insurance as outlined above.

Treasury Comment.--The Treasury believes that proposing the taxation of the interest element of cash value life insurance and annuity contracts to policyholders and annuitants now is not desirable because this will bring a strong adverse reaction. A great many people will be affected, including many in the middle and lower income levels. It is feared that these policyholders will join the numerous life insurance agents spread throughout the country in opposing this change.

Treasury Recommendation.--Treasury recommends that the interest element in life insurance and annuity contracts not be taxed.

Tax interest element in life insurance ______ •

Do not tax interest element in life insurance ______

Want to discuss further ______

Taxable Bond Option (TBO)

Present Law.--Interest payments received from debt obligations issued by State and local governments and their instrumentalities are exempt from Federal income tax. In contrast, interest payments on virtually all debt obligations issued by the Federal government are subject to Federal income tax.

Proposal.--State and local governments would be given the election to choose between the issuance of conventional tax exempt bonds and taxable bonds which receive a subsidy from the Treasury for a fixed percentage of the interest costs on these taxable bonds. The volume of debt issued in one form or the other would be entirely a matter for State and local governments to decide. Presumably, the decision would be made in the way which minimizes the net interest costs of their borrowing. For 2 years the Federal Government would subsidize the interest costs of States and local governments issuing taxable bonds by paying 35 percent of their interest costs on these bonds. Thereafter, on a permanent basis the interest subsidy rate would be 40 percent.

Revenue Estimate.--The net cost to the Treasury of the taxable bond option is made up of outlays due to the subsidy payments on taxable municipal bonds, minus higher revenues generated from the taxable interest income. For a 40 percent subsidy, the estimated costs after 1 year and 5 years respectively are:

	1 Year	5 Years
	($ Millions)	
Subsidy	78	770
Receipts	59	581
Net Budget Cost	19	189

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

- Unless some specific action is taken, tax exempt interest on State and local bonds will continue to be an important area of tax avoidance, allowing persons with large investment assets to pay no tax. The taxable bond option is an important, and probably the only feasible, way of achieving tax reform in this area. It will reduce the opportunity for avoiding taxes by the wealthy through the purchase of tax exempt bonds because fewer tax exempt bonds will be available and the interest rates they command will accordingly be reduced. Thus, tax avoidance on the part of the wealthy will be lessened because their return on these holdings will be reduced.

- TBO avoids both the political and a possible constitutional confrontation with State and local officials which would result from any attempt to tax interest on State and local bonds, either under the minimum tax or under the ordinary income tax.

- State and local governments benefit under TBO whether or not they individually issue taxable or tax exempt bonds: those issuing taxable debt benefit directly from the subsidy and those issuing tax exempt debt benefit from the lower interest rates then prevailing in the tax exempt market. However, the net Federal costs are based only on the volume of taxable issues and are made up of the subsidy payments on taxable bonds minus the increased revenue inflow from these bonds. The end result is a large benefit to State and local governments relative to the dollar cost to the Federal government (the savings to the State and local government is expected to be $8 for each $1 of cost to the Federal government).

° TBO has the advantage of providing States and localities with another market for their obligations. States and localities would be freed from a constrained tax exempt market which is dependent upon volatile sources of demand for tax exempt income. Thus, TBO ensures an adequate market for State and local financing both in the long term and over the business cycle even if traditional sources of lending become less available.

° Providing a lower subsidy in the first 2 years (35 percent then; later 40 percent) is designed to be sure that there is a gradual rather than a sudden shift from tax exempt to taxable bonds.

° In answer to complaints about cost, the program is less expensive than it superficially appears. The explicit subsidy will show up as a budget outlay, but the offsetting revenue inflow will not be separately distinguishable from other income tax receipts.

Con.--

° Many State and local organizations oppose the TBO because they believe (mistakenly) that after taxable bonds are well established the Federal government will withdraw the right of State and local governments to issue tax-exempt bonds.

° Some States and local governments fear that the Federal government will provide conditions under which the taxable bond option may be used and in this way provide regulations for State and local governments. (This is why it is important that no conditions be attached to the use of the TBO.)

° Some States and local governments fear that if the taxable bond option proves to be popular the market for tax-exempt bonds will dry up (in practice the market will be healthy; the interest charged in the tax-exempt area to the governmental unit should go down and local governments will benefit as fewer tax-exempt bonds are issued).

° Some States and local governments fear that the Federal government in the future will not meet the interest costs to which they have committed themselves on the grounds that the payments are dependent upon the appropriation process (this is no more true in this area than the many other entitlement programs where commitments are made in advance).

Treasury Recommendation.--States and localities should be given the option of issuing subsidized taxable bonds as well as conventional tax exempt bonds. The subsidy rate would be 35 percent for the first 2 years and 40 percent thereafter.

Agree ______

Disagree ______

Want to discuss further ______

Tax Treatment of Industrial Development Bonds

Present Law.--Industrial development bonds (IDB's) are securities issued by State and local governments for the benefit of private borrowers. Under current law, interest payments on these bonds are tax exempt only in the following cases:

(a) "Small issue" IDB's which may not exceed $1 million for individual borrowers or $5 million where the total cost of the plant in the locality is not much above this amount.

(b) IDB's issued for "particular functions" specified in the tax law, such as residential property for family units, sports facilities, convention facilities, airports, docks, wharves, sewage and solid waste facilities, gas, electric, and water facilities, pollution control facilities, and sites for industrial parks.

Tax exempt bonds, similar to IDB's, are also issued under housing legislation that is not part of the Internal Revenue Code.

Proposal.--The proposal would repeal the "particular function" exemption for IDB's except in the case of low and moderate income housing. The exemption would also still remain for the IDB's issued under the "small issue" provisions. Tax exemption provided under the special housing legislation would also be repealed.

Revenue Estimates.--The revenues generated by the proposal in the first year would be $26 million and in the fifth year $256 million.

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

- Interest on industrial development bonds is a source of tax avoidance in the same manner as are general obligation bonds issued by State and local governments, but cannot be justified as necessary to protect the exercise of local governmental functions.

- If the taxable bond option is accepted, some specific provision is needed to deal with industrial development bonds or they would automatically get a larger subsidy than they currently receive from the tax exempt market.

- Allowing private borrowers to use the tax exempt market increases borrowing costs for regular State and local government purposes. This not only raises the overall costs of State and local governments but also provides windfall gains to high bracket taxpayers who would buy tax exempt bonds with much lower interest yields.

- The tax law already provides many pollution control facilities with substantial tax advantages--through 60 month amortization. Under recommended changes in business taxation, a 10 percent investment tax credit rather than the present 5 percent credit would also be available for such facilities. Thus, there would be an offsetting, new advantage to industry for the construction of pollution abatement facilities which accounts for much of these bond issues.

- The proposal to repeal the exemption for pollution control financing is likely to receive a high degree of support from State and local government officials since the tax exemption for pollution control bonds injures the market for their bonds. The Municipal Finance Officers Association is on record as supporting this measure.

- The "small issue" exemption is greatly favored by State and local development authorities. Allowing these issues to remain in the tax exempt market is a reasonable compromise position.

- Continuing the exemption of low and moderate income housing bonds is considered an essential part of the current housing program.

- Tax exempt bonds authorized by housing legislation is outside the general control of the Internal Revenue Service. Special rules relating to tax exemption should not be administered by agencies other than the IRS.

Con.--

- Elimination of tax exempt IDBs is likely to produce a strong negative reaction by private users who currently enjoy reduced borrowing costs in the case of "particular functions."

- Major U.S. corporations avail themselves of these tax exempt sources of financing particularly for the construction of pollution control facilities. This tax exempt financing would no longer be available (but see discussion of more generous investment credit above).

- CEA believes the exemption for IDBs under the "small issue" provision is an undesirable tax expenditure (see below).

HUD Comment.--According to HUD, at least 40 percent of the new section 8 housing program is financed with funds raised with tax-exempt bonds. That Department asserts that any significant change in the market status of such bonds could cripple the section 8 program and retard the construction of low-income housing. Therefore, HUD requests that bonds issued to raise money for low, moderate or middle income housing be included within a category of bonds to be covered by the taxable bond option. (Note: As a result of the HUD comment these bonds have been left in the tax-exempt market and therefore are also eligible for the TBO.)

CEA Comment.--CEA believes that there should be no "small issue" exception for industrial development bonds. CEA also objects to leaving low and moderate income housing eligible for tax exempt industrial bonds.

Treasury Recommendations.--New industrial development bond financing, with the exception of "small issue" IDB's, should be mandated into the taxable market.

1. Repeal exempt status for industrial bonds other than housing bonds and other than "small issue" IDBs ________

   Do not repeal exempt status of any of the IDBs referred to above ________

Who recommends that?

2. Repeal exemption for "small issue" IDBs ________

   Do not repeal exemption for "small issue" IDBs ________

3. Leave low and moderate income housing eligible for tax exempt bonds ________

   Do not leave low and moderate income housing eligible for tax exempt bonds ________

4. Want to discuss issues further ________

THE WHITE HOUSE

WASHINGTON

September 23, 1977

MEMORANDUM FOR: THE PRESIDENT

FROM: STU EIZENSTAT Stu
BOB GINSBURG

SUBJECT: Option Paper No. VIII: International Taxation

1. Areas of Agreement. We support Treasury's recommendations to:

   (a) eliminate DISC by phasing it out in 1980 and 1981;

   (b) include in U.S. taxable income one half of the income from any voyage to, or from, the U.S. by ships or aircraft; and

   (c) require our various states to use the accounting method employed by the Federal government and most countries in determining the amount of income of foreign corporations which is applicable to their jurisdictions.

   Treasury and we agree that DISC is an ineffective (and, under GATT, illegal) export subsidy. If you want to take a tougher stand on DISC, you could propose eliminating it immediately in 1979 or phasing it out in 1979 and 1980 as opposed to 1980 and 1981; the 1979-1980 phase-out would pick up an additional $1.8 billion in revenue between now and 1981 and immediate elimination at least another $1 billion more. However, we do not think this is necessary; a more gradual phase-out period may help some companies in the adjustment process.

   Limiting the ability of our states to use whatever accounting methods they want to tax foreign multinationals will probably cause some adverse comment. Some state tax administrators will argue that this is a matter of states' rights and that they need every tool they can use to make sure foreign multinationals pay their proper tax liability. On the other hand, it appears that a number of states have been using questionable accounting practices to try to reach income of foreign based multinationals which really has nothing to do with the business in a state, e.g., trying to reach the income of a Hong Kong affiliate of a Japanese corporation which happens to do some business in California. Treasury states that this has become an unnecessary foreign policy irritant and may be discouraging some foreign multinationals from investing in the U.S.

2. Taxation of Accumulated DISC Profits. The legislation which created DISCs provided for a deferral not an exemption from income tax of the DISC profits. The legislation provides, for example, that if present DISCs go out of business, their accumulated untaxed profits will be subject to tax over a ten-year period. In its original presentation to you, Treasury proposed the immediate elimination of DISC and the taxation of the accumulated DISC profits over a ten-year period. Treasury now proposes a phased elimination of DISC and no taxation of accumulated DISC profits. Treasury believes that it will be politically difficult to tax the accumulated DISC profits because corporations (particularly those which had hoped never to pay tax on these profits) will argue it is like a retroactive tax.

We think, however, that this item will affect the credibility of our program and recommend that the accumulated, untaxed DISC profits be included in tax over a ten-year period:

-- As a matter of law, DISC provides for a temporary deferral not a permanent waiver of income tax.

-- This item involves $6 billion in tax revenues for the Treasury.

-- Foregoing our legal right to tax these profits could be regarded as a "giveaway" of $6 billion to the large corporations that account for most DISCs.

-- Almost from the time DISC was created in 1971, there has been pressure to repeal it and the DISC corporations have been on notice that their tax holiday could come to an end.

-- It is pointed out that the taxation of accumulated DISC profits may lead to accounting problems for some corporations which have not established adequate reserves. However, this would only apply to some corporations who themselves have chosen not to establish reserves for future taxes. It is, in any case, a technical accounting problem but not a serious financial problem because the tax would only have to be paid over a ten-year period. We are also advised that Treasury staff has developed a number of mechanisms which could handle the accounting problem.

3. Deferral. We recommend that the deferral of taxation on the profits of U.S.-controlled foreign subsidiaries be eliminated:

-- Deferral provides a tax incentive for U.S. multinational corporations to invest abroad rather than in the U.S. It is inconsistent with our concern for domestic capital formation and job creation.

-- Deferral is regarded by organized labor and average Americans as an incentive for multinationals to export jobs. It will be difficult for the Administration to argue for a free international trade policy if we express indifference to tax provisions which encourage our corporations to build plants abroad rather than here at home.

-- A Treasury staff paper shows that approximately 80% of the benefits from deferral go to large corporations ($250 million or more in assets) and approximately 85% of the foreign earnings subject to deferral arise from investments in developed countries (Western Europe, Japan, etc.) rather than LDCs. Thirty large multinationals get approximately 50% of all the benefits from deferral.

-- The argument that elimination of deferral would lead many foreign countries to raise their taxes on U.S. subsidiaries there ignores the facts that (a) we have tax and commercial treaties with most of the countries where there is major U.S. investment and those treaties would generally prohibit such discrimination and that (b) many of such countries would find it imprudent in any case to take specific measures to discriminate against U.S. investment as opposed to all other foreign investment. Accordingly, the argument that elimination of deferral will not mean much revenue for the Treasury is subject to considerable doubt. Elimination of deferral will curtail the ability of the multinationals to engage in "transfer pricing" and other financial manipulations, and this by itself should have a considerable positive effect on tax revenues. (The basic Treasury revenue estimate is approximately $500 million a year.)

-- The argument that deferral is proper to offset the benefits given to domestic investment through the investment tax credit and accelerated depreciation confuses rules of international taxation with those of domestic policy. No one would seriously argue that accelerated depreciation and investment tax credits, which are designed to stimulate domestic capital formation, are somehow being improperly denied to multinational investment in foreign countries. It should also be noted that investments by U.S. multinationals in foreign countries do not have to comply with domestic economic and social legislation such as environmental and safety standards and minimum wage legislation.

-- This is an item which will reflect upon the credibility of our entire program. Elimination of deferral has long been a basic objective of tax reformers. You made a number of campaign statements urging the elimination of deferral.

Tax Reform Option Paper No. VIII

International Taxation

Four tax reform proposals relating to U.S. corporations earning income in foreign countries and foreign corporations earning income in the United States are dealt with below: Domestic International Sales Corporations; the timing of the taxation of income of U.S. controlled foreign corporations; the taxation of foreign-flag shipping; and states' unitary apportionment method for taxing foreign income of foreign corporations. Possible revisions in the provision relating to the exclusion for Americans living abroad is not dealt with in this paper since it is believed that separate legislation should be sent up on this subject this year.

Domestic International Sales Corporations (DISC)

Present Law.--U.S. corporations may defer tax on a portion of their export related income by channeling it through a domestic subsidiary, called a Domestic International Sales Corporation (DISC). Most of the assets of a DISC must be concerned with exports and most of its income must be export related. Artificial pricing rules on transactions between the parent and its DISC permit a favorable allocation of profit to a DISC. The taxation of half of a DISC's income is deferred as long as these profits are invested in export related assets. In 1976 the portion of the income eligible for deferral was further limited to income in excess of the company's average export income in a moving base period. The purpose was to limit the benefits to increased export activity and to deny them where the exports would clearly have occurred anyway.

Proposal.--The tax deferral benefits granted to U.S. exporters using a DISC would be terminated for future exports. The Treasury Department recommends that DISC tax benefits be reduced by 50 percent in 1980 and eliminated for 1981 and subsequent years.

Alternative: Some believe that the DISC tax benefits should be reduced by 50 percent in 1979 and eliminated for 1980 and subsequent years.

Proposal.--The Treasury recommends that the tax deferral for accumulated untaxed DISC income from past exports would be continued as long as these profits are invested in export related assets.

Alternative: On the treatment of accumulated untaxed DISC income from past exports, some have recommended, in lieu of continuing deferral in these cases, that these amounts be gradually included in future taxable income over a 10 year period.

Revenue Estimate.--Taxing the income of DISCs would increase U.S. tax revenues by $0.9 billion at 1976 levels of income. The estimates of the revenue gains under the Treasury proposals are $145 million in 1980, $1,136 million in 1981, and $1,966 million in 1982. The revenue gains if phased down one year earlier would be $130 million in 1979, $1,078 million in 1980 and $1,865 in 1981.

If the accumulated tax deferred income from past exports were taxed in equal installments over 10 years, U.S. tax revenues would be increased by an additional $0.6 billion a year.

Discussion of the Issues.--The primary reasons for and against the proposal are:

Repeal of DISC

Pro.--

- DISC was introduced in 1971 when the United States did not believe it could devalue the dollar under existing international monetary arrangements. The flexible exchange rate system provides a far better stimulus for increased exports than do costly export-promotion programs.

- DISC has turned out to be a far more costly and less effective program than originally envisaged. According to a recent Treasury study, DISC may have contributed only $1 to $3 billion to U.S. exports in 1974 at a tax revenue cost of $1.2 billion--hardly a cost-effective program. Some studies have indicated that there would be no net export gains from this revenue loss.

- A panel has found DISC to be an export subsidy in violation of GATT. However, the panel has also found certain other tax practices of other countries to be in violation of GATT. One way to meet this problem is to repeal the DISC treatment and request the other nations to also correct their practices which are in violation of GATT.

Con.--

- DISC has promoted U.S. exports, U.S. employment, and the balance of payments. While it may not be an effective instrument in these respects, it is undesirable to repeal DISC immediately in the face of adverse trade balances of possibly as much as $27 billion, and with the prospect of a bad trade balance next year.

- Repealing DISC may make U.S. exports somewhat less competitive in world markets.

- As indicated above, DISC has been found to be a subsidy in violation of GATT. At the same time other countries have tax practices which the same panels have also found to be in violation of GATT but these countries have been unwilling to accept the GATT panels' findings. It is argued that DISC should not be repealed unilaterally, but kept as a bargaining chip in international negotiations.

Recapture of DISC Deferral for Prior Years

Pro.--

- The primary argument for recapture of the income deferred for prior years is that DISC was intended only to defer, not to waive, taxes on export income. Not to provide for the orderly termination of the deferral for past years in effect will permit the permanent deferral, or exemption, of the tax on this income and would mean that collections of $6 billion would be foregone permanently.

Con.--

- The primary argument against recapture of the income deferred for prior years is that DISC as proposed by Treasury, and as adopted by Congress in 1971, provided for deferral as long as the funds were invested in export related assets and the subsidiary met the requirements of DISC. Many companies have considered that this would be an indefinite period and accountants in many cases have recognized that this is an indefinite period by not requiring reserves to be set up for the taxes which become due upon the end of deferral. As a result many corporations are believed not to have established reserves to pay their ultimate tax liability on accumulated DISC income.

Department of State Comment.--The State Department urges the abolition of DISC.

CEA Comment.--CEA believes that the DISC tax deferrals accumulated in the past should be recaptured. It believes that DISC was designed to defer taxes on export income not to eliminate them for all time. CEA favors treating this amount as a loan on which interest would be collected, in addition to requiring the repayment of installments equal to 10 percent of the originally deferred amount each year. (This interest rate is discussed further in connection with the CEA proposal relating to deferral.)

CEA does not regard mistakes of the accounting profession in setting up, or not setting up, contingent liabilities, as an argument for not recapturing past deferrals. It believes that any problem in this regard could be taken care of by writing into the law rules for proper accounting for recaputred DISC profits.

Domestic Policy Staff Comment.--The Policy Staff believes there is no reason on the merits to forgive the DISC corporations $6 billion in tax liability, that the Treasury should not forego this revenue, and accordingly that the accumulated DISC tax deferrals should be subject to tax over a period of 10 years.

Commerce Comment.--Commerce believes that the DISC program has made some contributions to the increase in U.S. exports. However, it is aware that there is widespread belief that DISC benefits are not cost effective (based on the experience under the old DISC program) and agree that the elimination of DISC will increase popular support for the tax reform package. Accordingly, Commerce recommends that the DISC tax incentive be phased out gradually by reducing the share of DISC profits eligible for deferral. Commerce strongly opposes any measures that would recapture deferred taxes on DISC profits.

Department of Labor Comment.--DOL favors the elimination of DISC but believes this should be simultaneous with the elimination of tax deferral for U.S. owned foreign corporations, on the grounds that to eliminate DISC without action on deferral would favor employment abroad.

Treasury Comment.--With respect to the CEA proposal the DISC tax liability which has been deferred in the past, if it is to be paid back in installments, will be treated by the accounting profession as tax liability of the first year in which this change is made in the statute. This means that the companies involved will have adverse earnings rates after taxes in the year this change is made. Treasury believes that if the installment payment is to be required there should be sufficient contingencies in this requirement so that the accounting profession will not consider the full amount to be an immediate tax liability. The proposal to charge interest in these cases is believed to add complication and is not believed to be administratively feasible.

Treasury Recommendations.--DISC benefits should be phased out for future export income. DISC benefits should be reduced by 50 percent in 1980 and eliminated in 1981.

Phase down in 1980 and repeal in 1981
(Recommended by Treasury) ______

Phase down in 1979 and repeal in 1980 ______

Do neither ______

Want to discuss further ______

Treasury recommends that accumulated DISC benefits from past exports should not be recaptured.

Do not recapture DISC benefits for prior years
(Recommended by Treasury and Commerce) ______

Recapture DISC benefits for prior years
over a 10 year period
(Recommended by CEA and DPS) ______

Want to discuss further ______

Deferral of Taxation of Income of U.S. Controlled Foreign Corporations

Present Law.--Corporations organized under the laws of the United States are subject to taxation on their worldwide income. Since income earned abroad may also be subject to foreign tax, U.S. tax law, in order to prevent international double taxation, provides a credit for foreign income taxes in these cases (subject to limits) against the U.S. tax.

The foreign source income of foreign corporations controlled by U.S. persons (domestic corporations, citizens, residents) is generally not subject to taxation by the United States until it is remitted to U.S. shareholders as dividends. "Deferral" refers to the fact that the undistributed foreign source income of foreign corporations controlled by U.S. persons is generally not subject to current taxation by the United States.

An exception to the general rule of tax deferral provides that U.S. shareholders are taxed currently on the income of a controlled foreign corporation to the extent it has "tax haven" income (such as passive income and income artificially channelled to a low tax country).

Proposal.--Treasury does not recommend it but deferral could be eliminated. Income of U.S. controlled foreign corporations, subject to a foreign tax credit, would be taxed currently to the U.S. shareholders.

Alternatives: The deferral on all types of foreign income could be abbreviated: The income not brought home within a specified number of years (for example, 2 or 5 years) might be subject to taxation at the end of that time. Under another possibility some fraction (for example, one-half) of retained earnings might be taxed currently.

Revenue Estimate.--Because of the different factors involved this is a difficult provision to estimate. Elimination of deferral would increase Federal revenues by $0.4 billion a year at 1976 levels of income, assuming no foreign retaliation. The revenue gain would be $0.2 billion higher if elimination results in the allocation of more deductions against foreign income. The proposal to reduce corporate tax rates by 2 percentage points, however, would significantly reduce any revenue gain from eliminating deferral.

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

° Tax deferral provides an incentive for investing abroad rather than in the United States and that as a result deferral reduces job opportunities in the United States.

° The incentive to invest abroad in countries in the Far East and elsewhere offering tax holidays, low tax rates, immediate writeoffs of capital equipments, etc., is substantial. (The incentive is small or nonexistent, however, in high-tax countries such as Canada and Western Europe.)

° Deferral encourages multi-nationals to manipulate internal transfer prices and allocate income to low-tax countries. The Internal Revenue Service can limit tax avoidance by applying the arms length standard to transfer prices, but there are continuing problems of enforcement of this standard. If deferral were repealed, the incentive to avoid taxes would be materially reduced with a positive revenue effect for the Treasury.

° Eliminating deferral would simplify the taxation of foreign investment income since then the complex tax haven legislation could be repealed.

° Tax deferral could be provided to specific countries (presumably less developed) by tax treaty even though not generally available.

Con.--

° Few companies invest in less developed countries merely because of tax considerations. There is little evidence to suggest that the net impact of foreign investment on domestic employment is large. Other factors are more effective in stimulating domestic employment.

° Removing deferral is an incentive to a foreign country to raise its taxes to the American level of taxation on funds withdrawn from the country. This could mean that we will obtain little in revenue from removing tax deferral (even less would be received if the corporate rate is reduced by 2 percentage points as proposed). In fact, this proposal in the long run may result in a loss in revenue to us, since it will tend to encourage foreign countries to impose higher taxes on income withdrawn from their countries than they would if deferral were retained. (The ability to retaliate could be limited by tax and commercial treaties which the United States has with many countries where we have large investments. These treaties generally prohibit discrimination against U.S. investment. Also, other countries could find it unwise to discriminate against U.S. investment.)

° The balance of tax incentives now generally favors domestic investment over foreign investment. Although foreign investment benefits from deferral, it is denied the investment tax credit and accelerated depreciation (ADR). In the aggregate, these domestic incentives more than offset the effect of deferral. As a result repealing deferral would represent a step <u>away from</u> taxing domestic and foreign investment <u>at the same</u> effective rates. (On the other hand, U.S. investment abroad does not have to comply with U.S. environmental and safety legislation, minimum wage legislation, etc.)

° To deny tax deferral means that income from U.S. overseas investments will be discriminated against relative to other investments in the same foreign countries. The income on these other investments pays only the tax of the foreign country, and not any additional U.S. tax (and usually will not pay any tax to the country from which the investment originated).

° Because of differences in the tax laws of the United States and foreign countries, the absence of tax deferral would mean that specific income may be taxable under the laws of one country in one year and under the laws of the other in another year. If these differences occur within the carryover period (currently 2 years back and 5 years forward), there is some complexity in making the adjustment. If these differences are beyond the carryover period, international double taxation may result. (A longer carryover would be required to overcome this double taxation.)

Department of State Comment.--The State Department urges tax deferral be retained. It believes that the elimination of tax deferral would make it more difficult for U.S. corporations to compete internationally. In addition, the difficulties of administering a tax on the accrued earnings of foreign subsidiaries would be great and would provoke charges of interference in business activities of foreign countries.

CEA Comment.--The CEA believes deferral results in an unwarranted lowering of effective tax rates for individuals and corporations investing in "tax havens." Alternatively, the CEA suggests that the deferral of tax liability resulting from this treatment be considered a loan. The interest on this loan would be 100 basis points above the 1-year Treasury bill rate. This proposal is designed to deal with cash flow problems that might arise if immediate payments of deferred liabilities were required.

There are approximately $6 billion of unrepatriated earnings annually, and this is not counted as earnings for balance of payments purposes. If the Treasury is correct in thinking that foreign governments will raise their tax rates after a repeal of deferral, the capital inflows into the United States would be very substantial. To the extent that there is concern for the U.S. balance of payments position, therefore, repeal of deferral is a very attractive possibility. It could improve our external position at virtually no cost to the domestic economy.

Domestic Policy Staff Comment.--The Policy Staff favors the elimination of tax deferral.

Department of Commerce Comment.--Commerce supports the Treasury position to continue deferral of taxes on undistributed earnings of controlled foreign corporations. The present practice of not taxing foreign source income until returned to U.S. shareholders should be continued because: (1) other countries do not tax earnings of their overseas corporate holdings until such income is repatriated, (2) it would tend to discourage U.S. investment in low tax countries (often LDCs), (3) it may induce foreign governments to place a withholding tax on the constructive dividends implicit in ending tax deferral, and (4) a past Treasury study has indicated that under certain conditions the removal of the deferral may actually lose revenue.

Department of Labor Comment.--The DOL believes the simultaneous removal of tax deferral and DISC is desirable. It suggests that numerous economic analyses have demonstrated the unfairness and inequity of DISC and tax deferral. It suggests that the elimination of these two provisions together is desirable because of the offsetting impact they will have on decisions on whether to invest and produce abroad or to invest and produce--and create jobs--in the United States.

Treasury Comment.--Treasury believes that a study of the "pros" and "cons" set out above indicates that it would not be desirable to end tax deferral. The interest-loan in the CEA proposal eliminates the tax advantage of deferral, but it also would tend to discourage repatriations since this would trigger an increasing interest penalty. Unpaid, or delinquent taxes, today are subject to interest somewhat below the prime rate.

The repeal of deferral, as CEA suggests, probably will result in a temporary improvement in the balance of payments but the longer run effect would be adverse since if investments abroad are discouraged, there will be smaller foreign earning to be repatriated in subsequent years.

Treasury Recommendation.--The Treasury recommends that deferral be retained.

Retain present deferral of U.S. taxes (Recommended by Treasury) ______

Eliminate deferral of U.S. taxes (Recommended by CEA and DPS) ______

Want to discuss further ______

Taxation of Foreign Shipping

Present Law.--Foreign corporations and nonresident alien individuals are generally taxed by the United States only on their U.S. source income. A number of special rules deal with the taxation of foreign persons engaged in shipping and air transportation activities in the United States. These rules result in either no U.S. tax burden, or a very limited U.S. tax burden, on the income from such activities.

(1) The gross income of a nonresident alien or a foreign corporation does not include earnings derived from the operation of ships or aircraft registered under the laws of a foreign country which exempts shipping income of citizens and corporations of the United States.

(2) The United States has over 30 tax treaties providing for reciprocal exemptions which would apply even if there were no statutory exemption. These treaties are in effect with virtually all of the developed countries.

(3) In those situations where there is no exemption, the effective U.S. tax burden for foreign persons engaged in shipping and air transportation activities in the United States tends to be quite low. Gross income from U.S. sources is limited to income allocable to operations within U.S. 3 mile territorial limit. All income derived on the high seas is regarded as income from sources outside the United States.

<u>Proposal</u>.--<u>U.S. source income would include one-half of the income from any voyage to, or from, the United States by ships or aircraft</u>. Instead of exempting foreign shipping registered in any country giving a reciprocal exemption to U.S.-flag shipping, <u>the statutory exemption would be limited to ships "operated" by residents of the foreign country offering a reciprocal exemption</u>. Ships flying flags of convenience would no longer qualify for a U.S. tax exemption. (This rule in effect would not apply to air transportation, since flags of convenience for aircraft are not generally used.) Treaty (as opposed to statutory) exemptions would remain, but the United States would seek to renegotiate its treaties to limit exemptions to operators resident in a treaty country.

<u>Revenue Estimate</u>.--The estimated revenue gain from such a provision is $100 million a year.

<u>Discussion of the Issues</u>.--The primary reasons for and against this proposal are:

<u>Pro</u>.--

° By broadening the U.S. source rule to include one-half of the income from all incoming and outgoing voyages and by narrowing the statutory reciprocal exemption, the United States would hope to engage other countries in a multi-national effort to tax international shipping. In short, this proposal should be regarded as a modest step in the direction of eventually taxing shipping on a worldwide basis.

° The only shippers likely to pay higher taxes under this proposal are those flying Panamanian, Liberian, and other flags of convenience. Even those shippers may be able to avoid the higher taxes by reincorporating their operations in a treaty country, such as the United Kingdom or Greece.

Con.--

° If the United States were to begin taxing all shipping in and out of U.S. ports, foreign countries would retaliate by taxing U.S. ships calling on their ports. This retaliation would put U.S.-flag ships at a competitive disadvantage. (This would not happen under the proposal since the exemption in practice would continue while the Treasury attempted to get a consensus among non-flag of convenience countries that the operator's country would effectively tax international shipping.)

Department of Commerce Comments.--Commerce agrees in principle with this proposal, which would change current rules for the exemption of shipping income and discourage the use of flags of convenience and tax havens. Based on its preliminary understanding of the proposed rules changes, however, the Maritime Administration has raised some questions about the proposal which it is recommended that Treasury consider: (1) it may bring retaliation from those countries with whom we do not have treaties; (2) it could encourage developing nations to impose their own shipping taxes; (3) it may be ineffective against state-controlled merchant fleets, which will resist being taxed as a private enterprise; and (4) it may not succeed in taxing shippers using flag-of-convenience registry since nations such as Panama and Liberia can enact a tax exemption for U.S. flag ships thus putting pressure on the U.S. to grant them an exemption.

Treasury Comment.--The Treasury Department believes that when it has an opportunity to discuss this proposal further with the Maritime Administration most of the points raised by it can be answered. First, we do not believe that there will be retaliation from countries with which we do not have treaties, since a statutory exemption is available in these cases if the ship is operated by individuals of that country. Second, this proposal may encourage developing nations to impose their own shipping taxes with respect to imports or exports from their countries but this is consistent with the treatment the United States would provide for similar earnings. Third, the statutory exemption would be available for countries with state-owned merchant fleets and the United States has tax treaties with the more important countries having such fleets. Fourth, the flag of convenience registry would not assist these countries since the United States would provide reciprocal exemption only where the ship was operated by persons resident of the country providing the exemption. This, of course, would not be true in the case of the flag of convenience ships.

Treasury Recommendations.--The source rule for international air and sea transport, should be modified so that one-half of the income from each voyage is U.S. source income.

Agree ______

Disagree ______

Want to discuss further ______

The statutory reciprocal exemption of foreign shipping should apply only to operators resident in countries which exempt U.S. shipping.

Agree ______

Disagree ______

Want to discuss further ______

The existing treaty exemptions of foreign shipping would be continued but the new statutory guidelines would be followed for reciprocal exemption in negotiating future tax treaties.

Agree ______

Disagree ______

Want to discuss further ______

State Taxation of Foreign Based Multi-national Firms

Present Law.--Most states use some variation of a basic three-factor apportionment formula (sales, payroll, and property) for determining income earned within the State by a multistate corporation. In general, the apportionment formula is applied to income of a corporation only when the business activity from within the State is dependent upon, or contributes to, the business activities of the same corporation outside the State.

A few States, however, primarily California, Oregon, and Alaska, apply the three-factor formula on a "unitary" basis to the entire corporate group. Under this method, when an enterprise doing business in the State is part of a commonly controlled group of corporations, the State may require the controlled group to file a combined report of its worldwide income. A combined report is required whether or not the parent company or brother-sister companies do business in the State, as long as the group is engaged in a "unitary business" under the State's rules. A unitary business may be defined broadly, so that related entities which appear to be independently engaged in different kinds of activities may be aggregated into a unitary business and must, therefore, be included in a combined report to the tax authorities.

The combined report is, in effect, a consolidated return of the controlled group's worldwide income, although there may be separate returns for each member of the group. Income is apportioned to the State according to the ratio of in-State assets, sales, and payroll of the related companies to worldwide assets, sales, and payroll of all the related companies.

Proposal.--States would be required to use the conventional arm's length method (the method used by the Federal Government) in determining the amount of foreign income of foreign corporations allocable to their jurisdiction.

Revenue Estimate.--This proposal would have virtually no impact on U.S. Federal tax revenues. The impact on State tax revenues is difficult to determine but is believed to be small.

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

° The arm's length standard, under which corporations apply to inter-firm transactions those prices which would have been used by an independent buyer and seller, has become the international method of allocating income between countries. When one country or the states within that country apply an unconventional rule, international double taxation of income results. As state income tax rates have increased, this double taxation has become more onerous. This proposal would require the states to use the same method in taxing foreign income of foreign corporations as the Federal Government does.

° The unitary apportionment formula discourages foreign investment in the United States and, thus, hurts U.S. employment, the balance of payments and the extent of competition in U.S. industries. (California, for example, has found that the Japanese are reluctant to invest in California as long as the unitary concept is applied on an international basis.)

Con.--

° Some states believe that the unitary apportionment is simpler for them to administer than the arm's length method. Although the results of the Internal Revenue Service audits are available to the states, they believe they lack the legal resources to prevent state income tax avoidance by multinational firms.

° State tax administrators believe that the unitary method yields higher state tax revenues (this advantage being the other side of the double taxation coin), and as a result vigorously oppose Federal restrictions on their practices.

Treasury Recommendation.--The states should be prohibited from applying the unitary apportionment rule to tax foreign income of foreign corporations.

Agree ______

Disagree ______

Want to discuss further ______

Tax Reform Option Paper No. IX

Business Tax Reductions

Based upon the assumption that something approximating the tax reform program outlined in the first eight option papers is agreed to, this option paper develops what is believed to be a desirable tax reduction program for business.

This paper first sets out the reasons for a business tax reduction, outlines possible general business tax reductions, and then shows the strengths and weaknesses of the different features of these possible reductions. Finally, the paper concludes with a set of recommendations applicable in the case of small business.

I. Reasons for a General Business Tax Reduction

Need to Stimulate Capital Formation

Demand side.--If the economy is to return to a high employment level by 1981, a strong growth of business investment will be needed on the demand side. This is indicated by the fact that no other segment of the economy appears likely to take up the slack:

° Consumer spending has already achieved a relatively high level. The personal savings rate has fallen from about 7 percent in the last half of 1975 to about 4.75 percent in the first half of 1977. With the substantial rise in consumer spending which has already occurred, it is unlikely that consumer spending for some time will rise at any faster rate than the consumers' after-tax income. In fact, consumers may attempt to achieve a higher rate of savings.

° State and local spending has been a stimulative factor in the past 20 years; but with population growth slowing and reductions occurring in school age population, it appears likely that the level of services provided by State and local governments will not rise in the period ahead. This tendency is likely to be reinforced by citizen resistance to higher State and local taxes.

° While increasing real incomes and rising rates of family formation suggest rises in residential housing, given the high cost of this construction, substantial improvements in this area appear doubtful.

This leaves business capital spending as the area needed to provide an expansion in aggregate demand and as a major factor in providing a high level economy by 1981. However, the level of business fixed investment has not been satisfactory. There has been a slowdown in the rate of capacity growth in manufacturing from --

° 4.6 percent over the period 1948-1968,

° to 4 percent from 1968-1973,

° to 3 percent from 1973-1976.

° Last year capacity in manufacturing rose by less than 2.5 percent.

This indicates a much too slow rate of growth of investment for the long run.

Business Investment.--Nor has the level of investment in the current recovery been good. Real investment in machinery and equipment in the second quarter of this year was only 10.8 percent above the recession trough in the first quarter of 1975. In the last five cyclical expansions, on the average, real investment was 22.6 percent above earlier troughs at this stage of the cyclical expansion. Similarly, real investment in nonresidential structures has lagged. In the second quarter of this year, investment in nonresidential structures was only 2.7 percent above the recession trough, compared to 11.5 percent at this stage of previous recoveries. Charts 1 and 2 compare recoveries of producers' durable equipment and nonresidential structures this time with past experience.

Business investment is important because it creates job opportunities and income in the capital goods industry and in this way adds to the overall demand for goods and services. It is also important because by increasing and improving our productive capacity it makes possible the raising of our standard of living while at the same time lessening the chances of future inflationary pressures.

The recession of 1974-1975 reduced the rate of capacity utilization in manufacturing to its lowest post-war level, and this has deterred the expansion of capacity. The absence of recent capacity growth means that more emphasis needs to be placed upon increased capacity if we are to avoid shortages in the period ahead. This becomes more important since around 8 percent of manufacturers' new plant and equipment expenditures now are allocated to pollution abatement. Data available also make it clear that productivity growth, or output-per-hour, began slowing in the late 1960s and is now far below the level which would be expected based on the trend from 1948 to 1966.

There are two principal reasons for the sluggish business investment performance in recent years. One is the existence of excess capacity relative to current production, already referred to. Another reason--which a tax prgram can affect--is the high cost of capital or, viewed in other terms, the low after-tax rate of return on investment. There has been a downward trend in the rate of return on reproducible assets since the mid-1960s. This has been made worse by the fact that in recent years the ratio of debt to equity has been rising. While this ratio has declined somewhat in the past few years, an unbalanced financial structure with too much debt relative to equity makes our economic system increasingly vulnerable to cyclical changes.

All of these factors indicate the need for a higher rate of return on business income after tax, or encouragement of business investment in some other form.

Need for Reduction to Offset Other Business Tax Reforms

The proposals recommended in prior option papers which directly raise revenue from business amount to $4.2 to $5.0 billion. These are as follows:

	(billions)
DISC (with and without taxation of prior deferrals)	$0.9 to 1.2
Repeal of deferral (not recommended)	0.0 to 0.4
Tax 50 percent of shipping income	0.1
Reduce commercial bank bad debt deductions	0.2
Reduce savings and loan associations, etc., bad debt deductions	0.2
Tax credit unions	0.1

	(billions)
Reduce travel and entertainment deductions	0.8
Deny percentage depletion to hard minerals	0.7
Reduce real estate depreciation	0.3
Require accrual accounting for large family farms	*
Extend at risk limitation	*
Add intangible drilling costs to minimum tax	0.1
Tax corporate capital gains at regular rates	0.7
Industrial development bonds	0.1
Total	$4.2 to 5.0

Note: These and subsequent estimates are based on 1976 levels of income but with the provisions fully effective. The business provisions will increase revenues by $1.0 to $1.2 billion in Fiscal Year 1979, $2.9 to $3.4 billion in 1980, $4.7 to $5.3 billion in 1981, and $6.3 to $6.9 billion in 1982.

* Less than $0.05 billion.

In addition to the tax reform proposals directly affecting business, there are also a series of other provisions which, although affecting individuals, are likely to have an impact on business decisions. These items add to $7 or $8 billion.1/

The reforms suggested in prior option papers for business taxes are needed to improve the equity of the tax system. It is unlikely, however, in practice that these reforms can be obtained without business tax reductions which more than offset the revenue gain from these proposed changes. This then reinforces the need of the economy for a net tax reduction.

1/ The items referred to are taxing capital gains of individuals as ordinary income, lowering the exemption level for group term insurance, taxing individuals on the interest element in life insurance (not recommended), withholding on interest, providing limits on retirement plans, requiring health insurance to be nondiscriminatory, and taxing prepaid legal insurance.

Complement for the Personal Tax Reductions

The proposals primarily affecting individuals presented in prior option papers would reduce revenues as follows:

	(billions)
Revenue gain	$11.8 to 12.4*
Revenue loss	-27.1
Net individual reduction	$-15.4 to-14.8*

Traditionally, business tax reductions have been about a third the size of the reductions provided for individuals. This would suggest a net reduction of at least $4.9 billion for business in addition to offsetting the $4.2 billion to $5.0 billion in tax reform pickup. This implies an overall reduction of $9.1 billion to $9.9 billion for business based upon 1976 income levels. This order of magnitude is roughly consistent with the Council's budget Strategy II as discussed in the Overview.

II. Possible Business Tax Reductions

For reasons outlined below, the Treasury and CEA recommend the following business tax reduction proposals:

	(billions)
Relief from double taxation--allowing shareholders to treat as withholding a portion of the corporate tax equal to 20 percent of gross dividends	$ 2.5** — ?
Two percentage point reduction in the corporate rate (1 point in the lower income brackets)	2.7 ← Why rise so much annually?
Investment credit for industrial plant	1.1
Refundable? Increasing the investment credit limit to 90 percent of tax liability	0.1

* This variation in estimates depends upon whether social security payments above $15,000 for single persons and above $20,000 for married couples are included in the tax base or not.

** By itself, integration is expected to cost $2.8 billion. However, the elimination of the $100 dividend exclusion involves a revenue gain of $300 million, resulting in the net cost $2.5 billion.

	(billions)
Temporary increase in investment tax credit by 3 percentage points in 1978 and 1979, 2 points in 1980, and 1 point in 1981	79 80 81 82 5 → 4 → 3 → 2 *
Full investment credit for pollution abatement facilities	0.1
Depreciation based on work in progress	0.2
Total	$ 6.6

The reduction of $6.6 billion set out above would be offset by the $4.2 to $5.0 billion increase in various business taxes, leaving a net reduction of from $1.6 to $2.4 billion for businesses under this proposal. The components of the proposal are described below. However, there would be additional temporary losses of close to $4 billion a year in 1979 through 1980 with smaller losses in 1981 and 1982.

The impact of these programs over the years through 1982 are shown in table 1 at the end of this paper.

Relief From Double Taxation

Present Law.--Corporate profits are taxed twice, once under the corporate income tax and again when dividends are distributed to individual shareholders. The only recognition current law accords this double taxation is an exclusion from taxable income of $100 of dividend income for each individual taxpayer.

Proposal.--A portion of the current corporate income tax would be treated as a 20 percent withholding tax on dividends to the individual shareholder. The shareholder would include his gross dividends (that is, cash dividends plus 25 percent of these dividends given the 20 percent withholding tax) in income. The 20 percent would then be allowed as a credit in determining the shareholder's tax liability. As a part of this proposal, the current $100 dividend exclusion would be repealed.

The mechanism for attributing corporate tax paid to dividend distributions would permit corporations paying relatively low taxes to elect lower withholding rates for their shareholders than the maximum withholding rate allowable.

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* This involves no long-term revenue loss but involves a loss of $5.4 billion in 1979, $4.4 billion in 1980, $3.3 billion in 1981, and $1.7 billion in 1982.

The benefit of the investment credit would be flowed through to the shareholder by in effect treating the investment credit as tax paid by the corporation. In addition, a portion of the foreign tax credit amount for a transition period would be treated as corporate tax paid. (This gives corporations with a large proportion of their income from foreign sources an opportunity to adjust to the new treatment.)

Discussion of the Issues.--The primary reasons for and against the proposal are:

Pro.--

- Relief from double taxation decreases the bias of the present system against equity financing and in favor of debt financing. Reducing this bias should encourage new equity financing, decrease the ratio of debt to equity, and in this way reduce business financial risks.

- Corporate tax reductions tend to be regressive (assuming the benefit of the reductions is imputed to the shareholders), since corporate stock holdings tend to be concentrated among those in high-income groups. However, double tax relief is progressive among shareholders per dollar of dividends received and is less regressive among taxpayers as a whole than other forms of business tax relief.

- Double taxation discourages the use of a corporation in carrying on a business. This especially discriminates against business which for non-tax reasons need to use a corporate structure--for example, because they require large aggregations of capital or involve substantial risks (which need to be pooled or need to be limited). ?

- Relief from double taxation should encourage savings and investment because it will increase the after-tax rate of return on income from capital.

- Double taxation relief can directly compensate shareholders for the higher taxes on capital gains.

- The effect of double tax relief on the size of dividends is heavily affected by the following: (1) shareholders who want a corporation to distribute earnings tend to shift holdings to stock where larger earnings are distributed, or sell a portion of their stock; (2) corporations can develop automatic dividend reinvestment plans to encourage reinvestment by shareholders; (3) corporate shareholders under the dividend withholding mechanism will receive increased gross dividends (and therefore higher after-tax incomes) with unchanged cash dividend distributions.

- This proposal is consistent with the campaign pledge to impose a single tax on income, and a recommendation in this area is favored by Chairmen Ullman and Long.

Con.--

- Business tax relief which does not have a direct effect on investment--such as double tax relief and corporate rate reductions--is generally thought to be less stimulative of investment than relief which is directly related to investment--such as the investment credit or accelerated depreciation.

- Some feel that double taxation relief, provided only for distributed earnings, tends to encourage the distribution of corporate earnings rather than their retention for the use of the business.

- Any form of double taxation relief presents a number of complexities in the tax law which of necessity will make the law more complicated, rather than simpler. (The mechanism proposed involves little complication at the shareholder level. It is no more complicated than withholding on wages and salaries.)

Domestic Policy Staff Comment.--The Policy Staff believes your campaign statements and the expectations of the business/financial community can be adequately met with a 16-2/3 percent dividend withholding rate (involving a 20-percent gross-up factor). This would reduce the revenue loss from integration by $600 million at 1976 levels of income.

Treasury Comment.--The Treasury believes a rate of less than 20 percent would be viewed as inadequate in dealing with the double taxation problem and it would be unfortunate to start with a complicated 16-2/3 percent withholding rate.

Extending Investment Tax Credit to Industrial Structures

Present Law.--Investment in real property, or structures, is generally not eligible for the investment credit.

Proposal.--The general investment tax credit would be available for investment in industrial structures. Commercial and residential structures would, as under present law, not be eligible for the investment credit. (Industrial structures would also be eligible for the temporary increase in the investment credit discussed below.)

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

- The rate of investment in factories has not recovered from the recession to the same extent as investments in equipment. Providing the investment credit to this class of investment should have a significant stimulative effect.

- The credit is already available for some special purpose structures under current law, and that is a source of administrative difficulty. This problem is removed by extending the investment credit to industrial structures generally.

- The credit would more than offset the tax increase from requiring new industrial structures to use straight line depreciation. The combination of the 10 percent (or up to 13 percent) credit and straight line depreciation would be the equivalent to an investment credit of 7 percent (up to 10 percent) for industrial structures.

Con.--

- The Congress, especially the House, has in general become antagonistic to the investment credit. It is uncertain as to their view of extending the credit to structures.

- This will present an administrative problem in distinguishing between commercial and industrial structures; e.g., the distinction between warehousing at the manufacturing plant and elsewhere.

Raising the Investment Tax Credit Limit to 90 Percent of Liability

Present Law.--The investment credit now can offset all tax liability up to the level of $25,000; above that, the investment credit can generally offset no more than 50 percent of tax liability (there are some temporary exceptions for utilities, railroads, and airlines).

Proposal.--The limitation on the investment credit would at all levels of tax offset up to 90 percent of tax liability as otherwise determined. The limitation would be raised to 70 percent in 1980 and 90 percent thereafter. (A proposal in Option Paper No. VI would provide that the investment credit could no longer offset 100 percent of tax liability on the first $25,000 of tax.)

Discussion of the Issues.--The primary reasons for and against the proposal are:

Pro.--

° The investment credit limitation tends to favor profitable concerns since other companies cannot claim the full credit. Moving the limitation up to 90 percent reduces this effect on less profitable concerns.

° By raising the limits on the allownace of the credit, there will be more incentive to finance incremental investment for those firms which otherwise would have reached the limit of the offset.

° Permitting the investment credit to offset the tax completely, as has been proposed by Senators Long and Kennedy, would greatly expand the number of cases of persons or companies with substantial incomes which nevertheless pay no income tax.

° Many companies in a low profit range and those with no profit) have banks purchase equipment, obtain the investment credit, and then lease the equipment to them, presumably at a reduced rental rate reflecting part of the credit. This proposal should reduce the extent to which this complex procedure must be followed.

Con.--

° Moving the limitation up to 90 percent still will not help the unprofitable business. It will not satisfy Senators Long and Kennedy, who have publicly supported a refundable tax credit; i.e., a credit which is not limited by the firm's tax liability.

° Increasing the limitation from 50 percent to 90 percent of tentative tax liability means that a business can use the tax credit to largely escape taxation.

Temporary Increase in the Investment Credit

Present Law.--The present investment credit rate is 10 percent.

Proposal.--The general investment credit rate would be temporarily increased by 3 percentage points to 13 percent for 1978 and 1979, increased by 2 percentage points to 12 percent for 1980, and by 1 percentage point to 11 percent for 1981. Thereafter the rate would be 10 percent (assuming this rate is extended).

10% permanent?

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

- The temporary increase in the investment tax credit is carefully timed to deal with the varying needs for investment. The economy is currently operating well below full capacity, and as a result the stimulus from additional investment over the next 3 years should be desirable. After that period the economy should approach full employment and the increased investment incentives will then phase out when the potential for inflationary pressures arises.

- Making it clear that the investment credit will be phased down after 1979 should encourage business to advance their investments into the period where additional investment especially is needed.

- A temporary investment tax credit provides more short-run investment stimulus per dollar of revenue loss than most other business tax cuts.

- The temporary investment credit increase, since it is larger in the period immediately ahead, will dovetail in with some of the other business tax reductions (such as the corporate rate decrease) which occur later.

- Another way of looking at the economy requirements is as follows: (1) over the next 2 to 4 years, the emphasis must be on regaining full employment and correcting the imbalance between productive capacity and the labor force; (2) once those two problems are resolved, the priorities turn to increasing savings for more investment and to limiting the scope of incentives which distort investments. Thus the program then begins to phase out the extra investment incentives and phase in tax measures which remove distortions and emphasize savings--relief of double taxation and a corporate rate cut.

° Some members of Congress have shown an unwillingness to go along with further increases in the investment credit. However, they would be less likely to object to an increase which will clearly be temporary and will phase out.

Con.--

° Businesses prefer tax reductions which are not temporary in nature. They cannot take temporary measures into account as readily in their planning as permanent changes.

° Congress has shown a reluctance to support further investment credit increases.

° A temporary increase in the credit may in large part merely divert to 1978 and 1979 investment which would otherwise occur in subsequent years; as a result, investment in these year may be lower.

Increasing the Investment Tax Credit for Pollution Control Equipment

Present Law.--Investment in pollution control facilities placed in plants in existence before 1976 is eligible for 5-year amortization and a 5-percent investment credit. Alternatively, the equipment can be depreciated over its useful life and a 10-percent investment credit claimed.

Proposal.--Pollution control facilities currently qualifying for 5-year amortization would also be eligible for the full 10-percent investment credit.

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

° Pollution abatement facilities which either must, or should, be installed are viewed as poor investments since they generally do not increase profits. More generous treatment for these facilities will be favorably received by industry.

° In a prior recommendation it was suggested that industrial development bonds for pollution abatement facilities no longer be eligible for the benefits of tax-exempt financing. This proposal can be regarded as a tradeoff for the elimination of that advantage.

° Pollution control equipment would be especially stimulated in the period immediately ahead since it would also be eligible for the temporary increase in the investment tax credit.

° Similar tax treatment has been proposed as part of the energy program for pollution control equipment associated with coal conversion.

Con.--

° The size of the present investment credit allowed under present law varies with the number of years over which the asset is depreciated. The proposal here is a departure from this general rule, since under that rule only two-thirds of the investment credit would be allowed for an asset with a 5-year life.

° The difficulty with the use of special tax privileges for pollution control equipment is that this subsidizes only those investments which are readily identifiable as pollution control: it ignores new technologies which require new processes and therefore are not identifiable as pollution control activities.

° Environmental standards may require the installation of pollution abatement facilities. In these cases, no tax incentive is required to obtain this result.

Progress Payments and Depreciation

Present Law.--Depreciation of property generally begins at the time the property is placed in service. However, the investment credit may be claimed when payments are made on the property as it is being built, if the normal construction period for an asset is at least 2 years.

Proposal.--The time for beginning depreciation for utilities would be as progress payments are made but only for property eligible for the investment credit. This rule would apply only in the case of property for which the construction period is normally more than 2 years.

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

- Utilities believe that their depreciation as well as the investment credit should become available as payments are made rather than when property is put in service. They believe this should be available only for cases where the progress payments are included in the rate base for regulatory purposes.

Effect on rate rulings in states?

- Property used by a public utility is often property with a long construction period. As a result, this provision will help utilities which presently are facing difficulties in finding funds to finance required investments.

Con.--

- Under general rules depreciation is allowed over the period an asset is used in order to compensate the taxpayer for wear, tear, and obsolescence. This proposal departs from this basic concept, allowing depreciation to be obtained before use of the asset begins.

Reducing Corporate Tax Rate

Present Law.--The corporate tax rate is 20 percent on the first $25,000 of taxable income, 22 percent on income between $25,000 and $50,000, and 48 percent on income in excess of $50,000.

Proposal.--The corporate tax rate for income over $50,000 would be reduced by 2 percentage points, from 48 percent to 46 percent. In addition, both the 20-percent rate on the first $25,000 of taxable income and the 22-percent rate on income between $25,000 and $50,000 would be reduced by 1 percentage point.

Discussion of the Issues.--The primary reasons for and against this proposal are:

Pro.--

- A 2 percentage point rate reduction should aid in capital formation since it reduces the tax on income from capital and therefore leaves a larger after-tax income.

- This is probably the most popular form of business tax reduction.

- This provides a tax reduction for all corporations, including those which would not benefit from the increase in the investment credit.

- The corporate rate reduction is a simple change which can be made without difficulty and which can readily be decreased if adequate corporate tax reforms are not provided by the Congress.

- Since 1 of the 2 percentage points relates to the lower rates, this is a tax reduction, especially beneficial to small business.

Con.--

- A corporate rate reduction probably is not as stimulative of investment as a larger investment credit.

- The proposal would extend half of its corporate rate reduction to small business. Small business advocates in Congress probably can obtain support to make the entire corporate rate reduction applicable to small business. This would make the starting rate for corporations on the first $50,000 of income subject to tax at approximately the same rates as those applicable at the lowest individual rates. This will probably lead to an expansion in the movement to incorporate to avoid higher individual income tax rates.

Effective Dates

Most of these provisions would generally be effective in 1979. However, making the investment credit available for industrial structures would, almost of necessity, have to be put into effect as soon as it was announced. The same would be true of the 3 percentage point increase in the investment credit. To do otherwise would be likely to delay the construction of industrial plants or equipment until whatever later time the effective date applied. As a result, it is assumed that these changes would be effective on October 1, of this year which presumably will be within a few days of the time the proposals are announced. The 50-percent limit on the credit would be raised to 70 percent in 1980 and 90 percent thereafter. One percentage point of the corporate rate decrease would go into effect in 1980 and the other in 1981. The other changes would be effective at the beginning of 1979.

The business tax reductions are approximately one-third that of the individual income tax reductions outlined in prior option papers.

Commerce Department Comments.--The Commerce Department reviewed an earlier set of Treasury business tax proposals before they contained the proposal to provide for a temporary increase in the investment credit. Apart from this item, which was added subsequently, the Treasury proposals at that time were the same as those now included except that they also included a phasing in of double tax relief beginning at a 20 percent withholding rate level (now in the proposals) and increased in two subsequent steps in later years to 25 percent and then to 28 percent.

Commerce endorsed the Treasury proposals as good tax reform proposals but suggested that they underestimated the immediate need for increased capital spending. (Later, Treasury agreed and added the temporary increase in the investment credit recommended by Commerce.) Based upon discussions with business leaders, Commerce believed there is more support in the business community for partial relief from double taxation than for direct incentives for investment.

Commerce recommended a business tax package that included the business tax reductions in the earlier proposal and added a temporary investment credit (the type now in the proposal). In terms of what is now in the proposal, the Commerce Department endorsed all items included plus a phasing in of somewhat more relief from double taxation.

Treasury and CEA Recommendations.--Both recommend the following:

1. Relief from double taxation allowing shareholders to treat a portion of the corporate tax as a 20 percent withholding tax on dividends ($2.5 billion) (The Domestic Policy Staff believes that a 16-2/3 percent withholding rate is sufficient.)

2. Corporate rate reduction--2 point reduction with 1 point fully available to small business ($2.7 billion)

3. 10 percent investment credit for industrial structures ($1.1 billion)

4. Increasing investment credit limit to 90 percent of tax liability ($0.1 billion)

5. Temporary increase in investment credit by 3 points in 1978 and 1979, 2 points in 1980 and 1 point in 1981 (no long-run cost)

6. 10 percent investment credit for pollution abatement facilities ($0.1 billion)

7. Depreciation should begin at time of progress payments ($0.2 billion) ?

Agree _______

Disagree _______

Want to discuss further _______

III. Small Business

In addition to the general tax reductions for business discussed above, the Treasury also recommends specific reductions for small business. Most important of these is probably the 1 percentage point reduction in the corporate tax rate applicable to small business. This has been discussed above. In addition to this, the Treasury recommends simplifying depreciation for small business, easing the accumulated earnings tax, and liberalizing the subchapter S provisions.

Present Law.--Large corporations generally obtain accelerated depreciation by using the accelerated depreciation range (ADR) system. However, the complexity of this system has made it unattractive for small business.

A special accumulated earnings tax ranging from 27.5 percent to 38.5 percent is imposed on businesses retaining earnings beyond the "needs of the business." However, corporations can accumulate up to $150,000 without this tax being imposed, regardless of the needs of the business.

Subchapter S corporations are those which elect to have their income taxed to the shareholders in a manner similar to the tax treatment accorded partnerships and partners. However, these corporations are subject to a number of restrictive limitations. For example, these corporations may not obtain more than 20 percent of their receipts from passive investment sources, such as dividends and rents.

Proposal.--The ADR system of depreciation would be modified for small business to:

eliminate the present reporting requirements;

permit small business to select useful lives from a simpler list of asset categories; and

eliminate salvage value for small business taxpayers.

The accumulated earnings tax would be eased in two ways (1) a corporation which has reached the $150,000 ceiling will still have a safe haven if it retains no more than 25 percent of its current profits and (2) for corporations still subject to the accumulated earnings tax, the penalty would be reduced.

The subchapter S limits would be eased in several respects. One of the more important changes would repeal the passive income test for a subchapter S corporation.

Revenue Effect.--Proposals made here for small business, excluding the reduction in the corporate tax rate, would reduce revenues by $10 million.

Discussion of Issues.--The principal issues for and against this proposal are:

Pro.--

° The complexity of the tax law is a significant burden on small business. Simplifying the ADR depreciation rules would reduce this complexity as well as provide them with tax reductions.

° The accumulated earnings tax, though not often imposed, is sometimes used by Internal Revenue as a bargaining element in an audit examination. A safe haven rule permitting corporations to accumulate 25 percent of their earnings would reduce the fears of many small businesses that they may be subject to the accumulated earnings tax.

° If individual rates are reduced to a top rate of 50 percent and much of the double taxation is removed, the only tax avoided is the difference between the starting corporate rate and this amount. On this basis the second step in the accumulated earnings tax can be removed.

° Subchapter S is a form of fully integrating the corporate and individual taxes that should be liberalized.

Con.--

° Small business groups, while generally favorable to the proposal set out here, will want many other types of relief as well. For example, many of them will support a fully graduated corporate income tax.

° Questions can be raised as to why small business should be allowed to accumulate 25 percent of their earnings without concern for the accumulated earnings tax where they cannot establish that this is for the need of the business.

Other Agency Comments.--No agency has recommended against any of these proposals. The Small Business Administration, however, has proposed a series of additional changes favorable to small business, including graduated corporate rates ranging up to the income level of $150,000.

Treasury Recommendation.--The Treasury recommends the proposals outlined above. They would provide that:

The ADR accelerated depreciation changes should be made.

Agree ______

Disagree ______

Want to discuss further ______

The accumulated earnings tax liberalization should be adopted.

7 Agree ______

Disagree ______

Want to discuss further ______

The subchapter S decisions should be adopted.

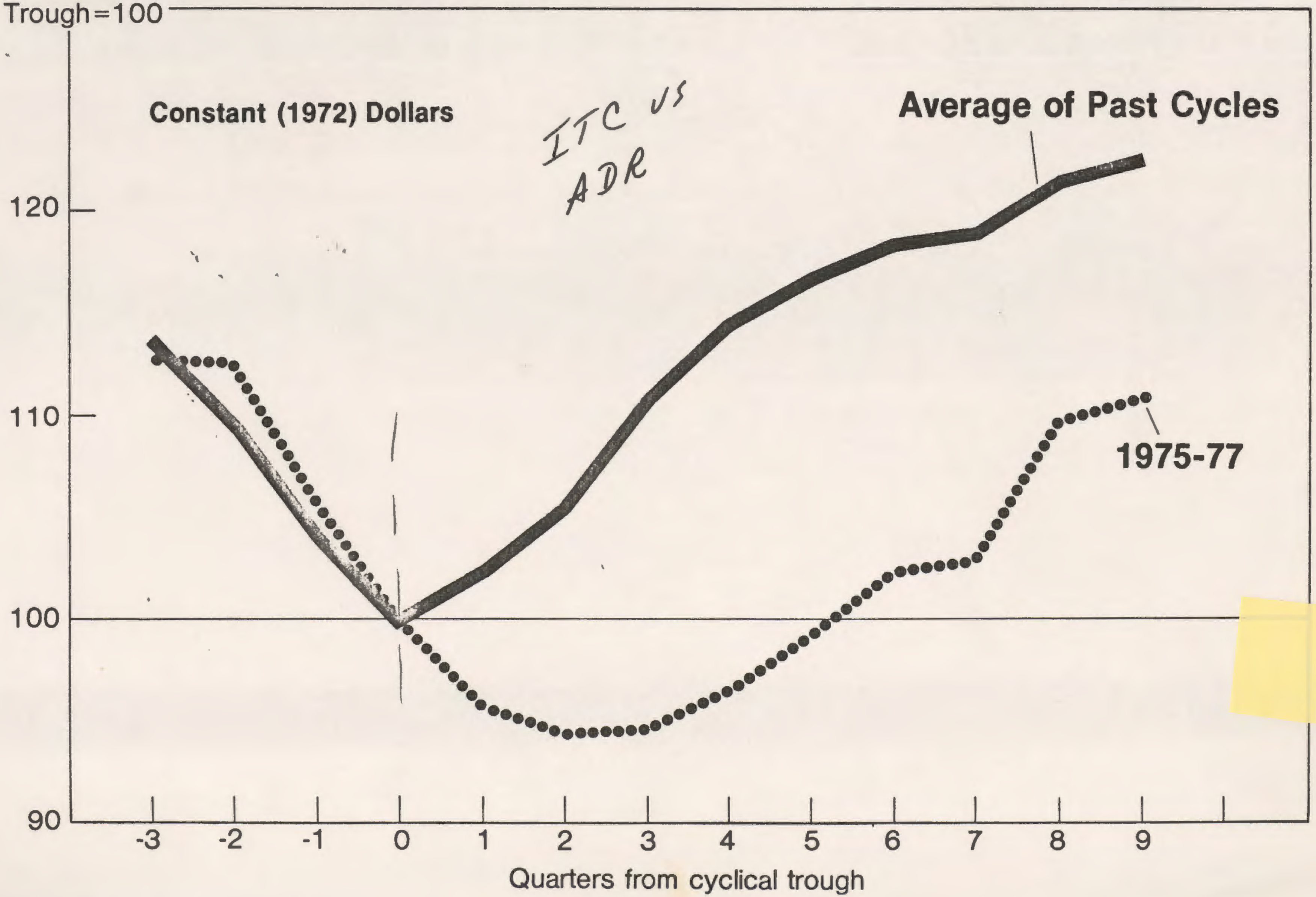
Agree ______

7 Disagree ______

Want to discuss further ______

Chart 1

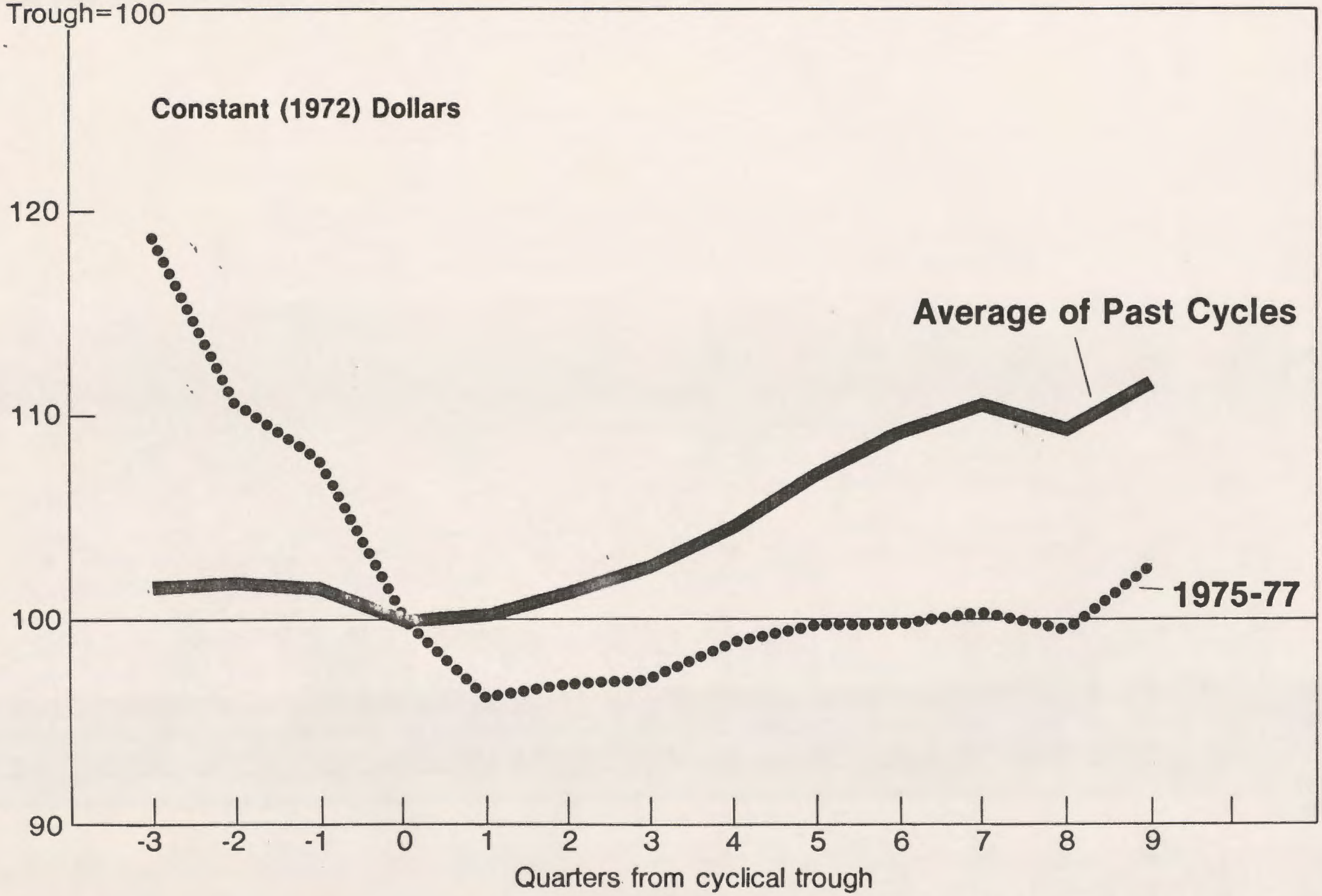
Recovery Comparisons of Producers' Durable Equipment



Pres. hand (?)

Chart 2

Recovery Comparisons of Nonresidential Structures



TABLES

APPENDIX TABLES

Comparisons of Effective Tax Rates under Present Law
and the Treasury Proposal

Individual Income Only

(1976 Levels of Income)

Expanded income class	Expanded income	Tax liability: Present law tax	Tax liability: Treasury proposal	Effective tax rates: Present law tax	Effective tax rates: Treasury proposal
($000)	(............. $ millions		................)	(......... percent	.........)
Less than 5	$ 57,557	$ 141	$ -260	0.2%	-0.5%
5 - 10	149,590	8,227	6,122	5.5	4.1
10 - 25	201,036	18,071	14,433	9.0	7.2
15 - 20	205,086	23,009	19,281	11.2	9.4
20 - 30	237,041	32,778	28,701	13.8	12.1
30 - 50	124,836	22,017	20,086	17.6	16.1
50 - 100	67,484	16,492	15,588	24.4	23.1
100 - 200	27,371	8,084	8,433	29.5	30.8
200 and over	21,573	6,476	7,621	30.0	35.3
Total	$1,091,573	$135,293	$120,009	12.4%	11.0%

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

Comparisons of Effective Tax Rates under Present Law
and the Treasury Proposal

Individual and Corporate Income

(1976 Levels of Income)

Expanded income class	Expanded income 1/	Tax liability		Effective tax rates	
		Present law tax	Treasury proposal	Present law tax	Treasury proposal
($000)	(............. $ millions		...............)	(......... percent	.........)
Less than 5	$ 65,426	$ 3,053	$ 2,397	4.6%	3.7%
5 - 10	159,261	11,805	9,462	7.4	5.9
10 - 25	212,583	22,343	18,460	10.5	8.7
15 - 20	215,754	26,956	23,024	12.5	10.7
20 - 30	255,093	39,457	35,028	15.5	13.7
30 - 50	144,104	29,146	26,832	20.2	18.6
50 - 100	86,522	23,536	22,293	27.2	25.8
100 - 200	41,978	13,489	13,602	32.1	32.4
200 and over	39,231	13,010	13,867	33.2	35.3
Total	$1,219,950	$182,793	$164,971	15.0%	13.5%

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Office of Tax Analysis

September 22, 1977

1/ Includes corporate income imputed to individuals.

Individual Income Tax Liabilities: Present Law and Proposed 1/

(1976 Levels of Income)

Expanded income class	Present law tax 2/		Treasury proposal tax		Tax change	
	Amount	Percentage distribution	Amount	Percentage distribution	Amount	Change as percent of present law tax
($000)	($ mil.)	(percent)	($ mil.)	(percent)	$ mil.	(... percent ....)
Less than 5	141	0.1	-260	-0.2	-401	-284.4
5 - 10	8,227	6.1	6,122	5.1	-2,105	-25.6
10 - 15	18,071	13.4	14,433	12.0	-3,638	-20.1
15 - 20	23,009	17.0	19,281	16.1	-3,728	-16.2
20 - 30	32,778	24.2	28,701	23.9	-4,077	-12.4
30 - 50	22,017	16.3	20,086	16.7	-1,931	-8.8
50 - 100	16,492	12.2	15,588	13.0	-904	-5.5
100 - 200	8,084	6.0	8,433	7.0	349	4.3
200 and over	6,476	4.8	7,621	6.4	1,145	17.7
Total	$135,293	100.0%	$120,009	100.0%	$-15,284	-11.3%

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Office of Tax Analysis

September 23, 1977

1/ Exclude business taxes imputed to individuals and proposals primarily affecting business income.
2/ 1977 law amended to reflect the $3,000 capital loss limitation effective under current law in 1978.

Note: Details may not add to totals due to rounding.

Estimated Tax Changes Resulting from Proposed Tax Reform Distributed by Expanded Income Class
(1977 law, 1976 levels of income)

Expanded income class	Changes primarily affecting individual income												
	$250 personal credit				Capital gains taxation		Itemized deduction changes					Tax shelters	
	Returns with tax decreases	Returns with tax increases	Reduced tax rates	Working spouse exclusion	Tax as ordinary income	Property transferred at death	Repeal gasoline tax deduction	Repeal sales tax deduction	Repeal miscellaneous tax and political contribution deduction	Deduction for medical and casualty expenses	Interest expense deduction	Real estate deduction	Limitation on credits
($000)													
Less than 5	-353	1	-136	*	13	*	*	1	*	1	*	9	*
5 - 10	-1,522	117	-1,065	-31	63	*	14	25	5	39	*	9	2
10 - 15	-1,863	434	-2,511	-313	74	*	60	110	27	135	*	7	7
15 - 20	-951	366	-3,616	-491	136	*	113	238	50	238	*	9	6
20 - 30	-229	752	-5,792	-535	92	*	200	488	89	381	*	16	10
30 - 50	-5	999	-4,719	-224	510	246	104	349	67	260	1	65	6
50 - 100	-1	641	-3,571	-74	769	457	38	208	50	141	4	94	3
100 - 200	*	154	-1,313	-17	738	363	9	72	29	48	2	96	2
200 and over	*	43	-1,223	-4	1,341	579	3	28	29	32	6	134	1
TOTAL	-4,925	3,508	-23,947	-1,688	3,735	1,645	542	1,518	348	1,276	14	439	38

($ millions)

Expanded income class	Changes primarily affecting individual income						
		Employee exclusions					
						Tax qualified retirement plans	
	Credit for elderly	Taxation of unemployment benefits	Group term life insurance	Group legal insurance	Nondiscrimination rule for health and group term life plans	Limit on benefits, contributions, integration, shareholder employees	Death benefit exclusion
($000)							
Less than 5	*	*	*	2	2	*	*
5 - 10	-2	*	*	6	2	*	*
10 - 15	-3	4	*	8	2	*	*
15 - 20	-3	14	1	8	2	*	*
20 - 30	-2	140	37	9	4	*	*
30 - 50	-1	70	54	4	5	2	8
50 - 100	*	42	47	1	5	2	9
100 - 200	*	6	19	*	4	3	4
200 and over	*	*	7	*	4	3	9
TOTAL	-11	275	166	40	30	10	30

Table 1

Net Revenue Losses Resulting from Business Tax Reduction Proposals

($ billions)

	1976 (Full year)	Fiscal Years 1979	1980	1981	1982
1. Relief from double taxation 1/ -- allowing shareholders to treat as withholding a portion of corporate tax equal to 20 percent of gross dividends	-2.5	-0.5	-3.9	-4.3	-4.6
2. Corporate rate reductions -- 2 percentage point cut in corporate rate (1 point on the top rate, 1 point on the lower rates)	-2.7	--	-1.1	-3.5	-5.0
3. Investment credit changes --					
Perm 10 percent credit for structures	-1.1	-2.0	-1.6	-1.9	-2.2
Increase limit to 70 percent of tax liability in 1980 and 90 percent thereafter	-0.1	--	-0.3	-0.7	-0.5
Temporary increase in investment credit by 3 points in 1978 and 1979, 2 points in 1980 and 1 point in 1981	--	-5.4	-4.4	-3.3	-1.7
Full credit for pollution abatement facilities	-0.1	*	-0.1	-0.1	-0.1
4. Depreciation based on work in progress ..	-0.2	--	*	-0.1	-0.3
Total gross cost of business reductions .	-6.6	-8.0	-11.4	-13.9	-14.3
5. Business tax reform proposals	4.0	1.0	2.7	4.5	6.0
Net business tax reduction	-2.6	-7.0	-8.6	-9.4	-8.3

Office of the Secretary of the Treasury
Office of Tax Analysis

September 18, 1977

1/ Includes the repeal of the dividend exclusion.

*Less than $0.05 billion.

($ millions)

Expanded income class	Changes primarily affecting individual income			Changes primarily affecting business income							
						Foreign			Financial institutions		
									Bad debt reserves		
	Scholarship, fellowship, GI bill, benefits	With-holding on interest income	Taxable bond option and industrial develop-ment bonds	Reduce double taxation of dividends	Small business	Repeal DISC	Tax 50 percent of shipping income	Corporate capital gains	Commercial banks	Mutual savings banks & savings & loans	Credit unions
($000)											
Less than 5	46	10	3	-246	-1	54	6	43	12	10	8
5 - 10	109	104	20	-223	-1	60	7	49	14	12	9
10 - 15	10	149	26	-226	-1	70	8	56	16	14	10
15 - 20	2	128	22	-188	-1	63	7	51	14	12	9
20 - 30	2	222	39	-325	-1	115	13	93	27	22	16
30 - 50	1	239	28	-357	-2	134	16	108	31	26	20
50 - 100	*	228	3	-326	-2	137	16	110	31	27	20
100 - 200	*	128	2	-254	-1	107	12	86	25	21	15
200 and over	*	149	4	-320	*	130	15	104	30	25	19
TOTAL	170	1,356	147	-2,463	-10	870	100	700	200	169	126

($ millions)

Expanded income class	Changes primarily affecting business income								Total tax changes		
	Repeal depletion on hard minerals	Amend entertainment deductions	Corporate real estate shelters	Corporate family farm accounting	At risk limitation	Minimum tax on intangible drilling costs	Expensing of reforestation costs	Business tax reductions	Changes primarily affecting individual income	Changes primarily affecting business income	Total
($000)											
Less than 5	45	46	16	*	1	5	-3	-251	-401	-255	-656
5 - 10	51	52	19	*	1	*	-4	-284	-2,105	-238	-2,343
10 - 15	59	60	21	*	2	*	-5	-329	-3,638	-245	-3,883
15 - 20	53	54	19	*	1	1	-4	-295	-3,728	-204	-3,932
20 - 30	97	99	36	*	3	1	-7	-541	-4,077	-352	-4,429
30 - 50	113	116	41	*	3	5	-8	-629	-1,931	-383	-2,314
50 - 100	117	118	42	15	3	13	-8	-652	-904	-339	-1,243
100 - 200	90	92	33	11	2	33	-6	-502	349	-236	113
200 and over	109	112	40	4	3	57	-7	-609	1,145	-288	857
TOTAL	734	750	267	30	20	114	-53	-4,092	-15,284	-2,538	-17,822

Expanded income class	Additional Items Under Broader Plan: Changes Primarily Affecting Individual Income: Taxation of Social Security and Railroad Retirement Benefits	Tax Interest Element of Annuity and Insurance Contracts	Total	Changes Primarily Affecting Business Income: Recapture of DISC Benefits	Eliminate Deferral of Foreign Source Income	Total	Total Changes Including Additional Items In Broader Plan: Changes Primarily Affecting Individual Income	Changes Primarily Affecting Business Income	Total
($000)									
Less than 5	*	3	3	22	26	48	-398	-207	-605
5 - 10	*	53	53	25	28	53	-2,052	-185	-2,237
10 - 15	7	136	143	29	33	62	-3,495	-183	-3,678
15 - 20	37	175	212	26	30	56	-3,516	-148	-3,664
20 - 30	218	261	479	47	55	102	-3,598	-250	-3,848
30 - 50	224	197	421	55	64	119	-1,510	-264	-1,774
50 - 100	107	143	250	57	65	122	-654	-217	-871
100 - 200	21	56	77	44	51	95	426	-141	285
200 and over	3	26	29	54	61	115	1,174	-173	1,001
TOTAL	616	1,051	1,667	359	413	772	-13,617	-1,766	-15,383

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

Permanent Rate Schedule for 1981

Joint Rate Schedule

Taxable income bracket	Tax at low end of bracket	Marginal rate in bracket
	(......... dollars ....)	(.......... percent ....)
$ 0 - 1,000	0	10%
1,000 - 2,000	100	13
2,000 - 3,000	230	16
3,000 - 4,000	390	17
4,000 - 8,000	560	18
8,000 - 12,000	1,280	19
12,000 - 16,000	2,040	21
16,000 - 20,000	2,880	23
20,000 - 24,000	3,800	25
24,000 - 28,000	4,800	28
28,000 - 32,000	5,920	30
32,000 - 36,000	7,120	32
36,000 - 40,000	8,400	34
40,000 - 44,000	9,760	36
44,000 - 48,000	11,200	38
48,000 - 54,000	12,720	41
54,000 - 62,000	15,180	44
62,000 - 70,000	18,700	47
70,000 and over	22,460	50

Office of the Secretary of the Treasury
Office of Tax Analysis

September 21, 1977

Note: The zero bracket is now shown in this table. To include the zero bracket, increase all taxable incomes shown by $3,200

Permanent Rate Schedule for 1981

Single Rate Schedule

Taxable income bracket	Tax at low end of bracket	Marginal rate in bracket
	(........ dollars ....)	(........... percent ....)
$ 0 - 500	0	10%
500 - 1,000	50	12
1,000 - 2,000	110	15
2,000 - 3,000	260	18
3,000 - 4,000	440	19
4,000 - 8,000	630	20
8,000 - 12,000	1,430	22
12,000 - 16,000	2,310	24
16,000 - 20,000	3,270	27
20,000 - 24,000	4,350	29
24,000 - 28,000	5,510	32
28,000 - 32,000	6,790	34
32,000 - 36,000	8,150	37
36,000 - 40,000	9,630	39
40,000 - 44,000	11,190	42
44,000 - 48,000	12,870	44
48,000 - 54,000	14,630	47
54,000 and over	17,450	50

Office of the Secretary of the Treasury
Office of Tax Analysis

September 21, 1977

Note: The zero bracket is now shown in this table. To include the zero bracket, increase all taxable incomes shown by $2,200.

Permanent Rate Schedule for 1981

Head-of-household Rate Schedule

Taxable income bracket	Tax at low end of bracket	Marginal rate in bracket
	(......... dollars ....)	(.......... percent ....)
0 - 500	0	10.0%
500 - 1,000	50	11.0
1,000 - 2,000	105	14.0
2,000 - 3,000	245	17.0
3,000 - 4,000	415	18.0
4,000 - 8,000	595	19.0
8,000 - 12,000	1,355	20.5
12,000 - 16,000	2,175	22.5
16,000 - 20,000	3,075	25.0
20,000 - 24,000	4,075	27.0
24,000 - 28,000	5,155	30.0
28,000 - 32,000	6,355	32.0
32,000 - 36,000	7,635	34.5
36,000 - 40,000	9,015	36.5
40,000 - 44,000	10,475	39.0
44,000 - 48,000	12,035	41.0
48,000 - 54,000	13,675	44.0
54,000 - 62,000	16,315	47.0
62,000 - 70,000	20,075	48.5
70,000 and over	23,955	50.0

Office of the Secretary of the Treasury
Office of Tax Analysis

September 21, 1977

Note: The zero bracket is now shown in this table. To include the zero bracket, increase all taxable incomes shown by $2,200.

Transition Rate Schedule for 1980

Joint Rate Schedule

Taxable income bracket	Tax at low end of bracket	Marginal rate in bracket
	(......... dollars ....)	(.......... percent ....)
$ 0 - 1,000	0	10%
1,000 - 2,000	100	13
2,000 - 3,000	230	16
3,000 - 4,000	390	17
4,000 - 8,000	560	18
8,000 - 12,000	1,280	19
12,000 - 16,000	2,040	21
16,000 - 20,000	2,880	23
20,000 - 24,000	3,800	26
24,000 - 28,000	4,840	29
28,000 - 32,000	6,000	32
32,000 - 36,000	7,280	35
36,000 - 40,000	8,680	37
40,000 - 44,000	10,160	39
44,000 - 48,000	11,720	41
48,000 - 54,000	13,360	44
54,000 - 62,000	16,000	47
62,000 - 70,000	19,760	49
70,000 - 90,000	23,680	51
90,000 -120,000	33,880	53
120,000 and over	49,780	55

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

Note: The zero bracket is now shown in this table. To include the zero bracket, increase all taxable incomes shown by $3,200.

Transition Rate Schedule for 1980

Single Rate Schedule

Taxable income bracket	Tax at low end of bracket	Marginal rate in bracket
	(....... dollars ....)	(.......... percent ....)
$ 0 - 500	0	10%
500 - 1,000	50	12
1,000 - 2,000	110	15
2,000 - 3,000	260	18
3,000 - 4,000	440	19
4,000 - 8,000	630	20
8,000 - 12,000	1,430	22
12,000 - 16,000	2,310	24
16,000 - 20,000	3,270	27
20,000 - 24,000	4,350	30
24,000 - 28,000	5,550	33
28,000 - 32,000	6,870	36
32,000 - 36,000	8,310	40
36,000 - 40,000	9,910	42
40,000 - 44,000	11,590	45
44,000 - 48,000	13,390	47
48,000 - 54,000	15,270	49
54,000 - 62,000	18,210	52
62,000 - 70,000	22,370	53
70,000 and over	26,610	55

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

Note: The zero bracket is now shown in this table. To include the zero bracket, increase all taxable incomes shown by $2,200

Transition Rate Schedule for 1980

Head-of-household Rate Schedule

Taxable income bracket	Tax at low end of bracket	Marginal rate in bracket
	(.......... dollars ....)	(........... percent ....)
0 - 500	0	10.0%
500 - 1,000	50	11.0
1,000 - 2,000	105	14.0
2,000 - 3,000	245	17.0
3,000 - 4,000	415	18.0
4,000 - 8,000	595	19.0
8,000 - 12,000	1,355	20.5
12,000 - 16,000	2,175	22.5
16,000 - 20,000	3,075	25.0
20,000 - 24,000	4,075	28.0
24,000 - 28,000	5,195	31.0
28,000 - 32,000	6,435	34.0
32,000 - 36,000	7,795	37.5
36,000 - 40,000	9,295	39.5
40,000 - 44,000	10,875	42.0
44,000 - 48,000	12,555	44.0
48,000 - 54,000	14,315	47.0
54,000 - 62,000	17,135	49.5
62,000 - 70,000	21,095	50.5
70,000 - 90,000	25,135	53.0
90,000 -120,000	35,735	54.0
120,000 and over	51,935	55.0

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

Note: The zero bracket is now shown in this table. To include the zero bracket, increase all taxable incomes shown by $2,200.

Transition Rate Schedule for 1979

Joint Rate Schedule

Taxable income bracket	Tax at low end of bracket	Marginal rate in bracket
	(......... dollars ....)	(......... percent ....)
$ 0 - 1,000	0	10%
1,000 - 2,000	100	13
2,000 - 3,000	230	16
3,000 - 4,000	390	17
4,000 - 8,000	560	18
8,000 - 12,000	1,280	19
12,000 - 16,000	2,040	21
16,000 - 20,000	2,880	24
20,000 - 24,000	3,840	27
24,000 - 28,000	4,920	30
28,000 - 32,000	6,120	34
32,000 - 36,000	7,480	38
36,000 - 40,000	9,000	40
40,000 - 44,000	10,600	42
44,000 - 48,000	12,280	44
48,000 - 54,000	14,040	47
54,000 - 62,000	16,860	50
62,000 - 70,000	20,860	52
70,000 - 90,000	25,020	54
90,000 -110,000	35,820	57
110,000 -140,000	47,220	58
140,000 and over	64,620	60

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

Note: The zero bracket is now shown in this table. To include the zero bracket, increase all taxable incomes shown by $3,200.

Transition Rate Schedule for 1979

Single Rate Schedule

Taxable income bracket	Tax at low end of bracket	Marginal rate in bracket
	(....... dollars ....)	(........... percent ....)
$ 0 - 500	0	10%
500 - 1,000	50	12
1,000 - 2,000	110	15
2,000 - 3,000	260	18
3,000 - 4,000	440	19
4,000 - 8,000	630	20
8,000 - 12,000	1,430	22
12,000 - 16,000	2,310	24
16,000 - 20,000	3,270	28
20,000 - 24,000	4,390	31
24,000 - 28,000	5,630	34
28,000 - 32,000	6,990	38
32,000 - 36,000	8,510	42
36,000 - 40,000	10,190	45
40,000 - 44,000	11,990	48
44,000 - 48,000	13,910	50
48,000 - 54,000	15,910	51
54,000 - 62,000	18,970	54
62,000 - 70,000	23,290	56
70,000 - 80,000	27,770	58
80,000 and over	33,570	60

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

Note: The zero bracket is now shown in this table. To include the zero bracket, increase all taxable incomes shown by $2,200

Transition Rate Schedule for 1979

Head-of-household Rate Schedule

Taxable income bracket	Tax at low end of bracket	Marginal rate in bracket
	(.......... dollars ....)	(........... percent ....)
0 - 500	0	10.0%
500 - 1,000	50	11.0
1,000 - 2,000	105	14.0
2,000 - 3,000	245	17.0
3,000 - 4,000	415	18.0
4,000 - 8,000	595	19.0
8,000 - 12,000	1,355	20.5
12,000 - 16,000	2,175	22.5
16,000 - 20,000	3,075	26.0
20,000 - 24,000	4,115	29.0
24,000 - 28,000	5,275	32.0
28,000 - 32,000	6,555	36.0
32,000 - 36,000	7,995	40.0
36,000 - 40,000	9,595	42.5
40,000 - 44,000	11,295	45.0
44,000 - 48,000	13,095	47.0
48,000 - 54,000	14,975	49.0
54,000 - 62,000	17,915	52.0
62,000 - 70,000	22,075	54.0
70,000 - 90,000	26,395	56.5
90,000 -110,000	37,695	58.5
110,000 -140,000	49,395	59.0
140,000 and over	67,095	60.0

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

Note: The zero bracket is now shown in this table. To include the zero bracket, increase all taxable incomes shown by $2,200.

Comparison of 1977 Tax Liability and Proposed Tax Liability
Under Treasury Proposal of September 21, 1977
Joint Returns
No Dependents

Expanded income class	1977 law tax			Treasury proposal			Change in tax liability		
	Amount	Percentage distribution	Average tax liability	Amount	Percentage distribution	Average tax liability	Amount	Average tax liability: Amount	Average tax liability: Percentage change from 1977 law
($000)	($ mil.)			($ mil.)			($ mil.)		
Less than 10	1,018	2.6	168	532	1.4	88	-486	-80	-47.7
10 - 15	4,235	10.7	1,104	3,546	9.6	925	-689	-179	-16.3
15 - 20	6,730	17.0	2,084	6,048	16.4	1,873	-682	-211	-10.1
20 - 30	10,359	26.2	3,615	9,331	25.3	3,256	-1,028	-359	-9.9
30 - 50	6,947	17.6	6,921	6,534	17.7	6,509	-413	-412	-6.0
50 - 100	4,949	12.5	17,020	4,855	13.2	16,696	-94	-324	-3.6
100 - 200	2,724	6.9	40,403	2,990	8.1	44,349	266	3,946	9.8
200 and over	2,579	6.5	132,121	3,068	8.3	157,172	489	25,051	19.0
Total	$39,533	100.0%	$ 2,276	$36,904	100.0%	$ 2,124	$-2,629	$ -152	6.7%

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

Note: Details may not add to totals due to rounding.

Table does not include imputed corporate tax.

1977 law includes a $3,000 capital loss offset against ordinary income scheduled under present law to be effective beginning in 1978.

Comparison of 1977 Tax Liability and Proposed Tax Liability
Under Treasury Proposal of September 21, 1977
Joint Returns
One Dependent

Expanded income class	1977 law tax: Amount	1977 law tax: Percentage distribution	1977 law tax: Average tax liability	Treasury proposal: Amount	Treasury proposal: Percentage distribution	Treasury proposal: Average tax liability	Change in tax liability: Amount	Change in tax liability: Average tax liability: Amount	Change in tax liability: Average tax liability: Percentage change from 1977 law
($000)	($ mil.)			($ mil.)			($ mil.)		
Less than 10	163	0.8	65	-130	-0.7	-52	-293	-117	-179.8
10 - 15	2,491	11.7	1,024	1,794	9.6	738	-697	-286	-28.0
15 - 20	3,955	18.5	1,922	3,335	17.9	1,621	-620	-301	-15.7
20 - 30	6,306	29.5	3,392	5,570	29.9	2,996	-736	-396	-11.7
30 - 50	3,920	18.4	6,709	3,527	18.9	6,036	-393	-673	-10.0
50 - 100	2,456	11.5	16,938	2,299	12.3	15,855	-157	-1,083	-6.4
100 - 200	1,222	5.7	41,993	1,229	6.6	42,234	7	241	0.6
200 and over	845	4.0	121,583	1,017	5.5	146,331	172	24,748	20.4
Total	$21,358	100.0%	$ 2,224	$18,640	100.0%	$ 1,941	$-2,718	$ -288	-12.7

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

Note: Details may not add to totals due to rounding.

Table does not include imputed corporate tax.

1977 law includes a $3,000 capital loss offset against ordinary income scheduled under present law to be effective beginning in 1978.

Comparison of 1977 Tax Liability and Proposed Tax Liability
Under Treasury Proposal of September 21, 1977
Joint Returns
Two Dependents

Expanded income class	1977 law tax: Amount	1977 law tax: Percentage distribution	1977 law tax: Average tax liability	Treasury proposal: Amount	Treasury proposal: Percentage distribution	Treasury proposal: Average tax liability	Change in tax liability: Amount	Change in tax liability: Average tax liability: Amount	Change in tax liability: Average tax liability: Percentage change from 1977 law
($000)	($ mil.)			($ mil.)			($ mil.)		
Less than 10	16	0.1	9	-132	-0.7	-76	-148	-85	-925.0
10 - 15	2,008	8.9	867	1,140	6.0	492	-868	-375	-43.2
15 - 20	4,010	17.9	1,739	3,129	16.4	1,357	-881	-382	-22.0
20 - 30	6,771	30.2	3,117	5,827	30.6	2,682	-944	-435	-13.9
30 - 50	4,374	19.5	6,287	3,883	20.4	5,582	-491	-705	-11.2
50 - 100	3,140	14.0	16,336	2,880	15.1	14,984	-260	-1,352	-8.3
100 - 200	1,312	5.8	40,885	1,311	6.9	40,854	-1	-31	0.0
200 and over	826	3.7	127,666	984	5.2	152,087	158	24,421	19.1
Total	$22,456	100.0%	$ 2,376	$19,022	100.0%	$ 2,012	$-3,434	$ -364	-15.3

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

Note: Details may not add to totals due to rounding.

Table does not include imputed corporate tax.

1977 law includes a $3,000 capital loss offset against ordinary income scheduled under present law to be effective beginning in 1978.

Comparison of 1977 Tax Liability and Proposed Tax Liability
Under Treasury Proposal of September 21, 1977
Joint Returns
Three Dependents

Expanded income class	1977 law tax			Treasury proposal			Change in tax liability		
								Average tax liability	
	Amount	Percentage distribution	Average tax liability	Amount	Percentage distribution	Average tax liability	Amount	Amount	Percentage change from 1977 law
($000)	($ mil.)			($ mil.)			($ mil.)		
Less than 10	-39	-0.3	-41	-69	-0.6	-73	-30	-32	-76.9
10 - 15	790	5.9	693	324	2.9	284	-466	-409	-59.0
15 - 20	2,154	16.1	1,562	1,523	13.5	1,105	-631	-457	-29.3
20 - 30	3,654	27.3	2,867	3,064	27.1	2,403	-590	-464	-16.1
30 - 50	2,765	20.6	5,872	2,471	21.8	5,248	-294	-624	-10.6
50 - 100	2,441	18.2	15,924	2,196	19.4	14,326	-245	-1,598	-10.0
100 - 200	1,027	7.7	40,417	1,055	9.3	41,519	28	1,102	2.7
200 and over	613	4.6	126,915	756	6.7	156,522	143	29,607	23.3
Total	$13,405	100.0%	$ 2,488	$11,320	100.0%	$ 2,101	$-2,085	$ -387	-15.6%

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

Note: Details may not add to totals due to rounding.

Table does not include imputed corporate tax.

1977 law includes a $3,000 capital loss offset against ordinary income scheduled under present law to be effective beginning in 1978.

Comparison of 1977 Tax Liability and Proposed Tax Liability
Under Treasury Proposal of September 21, 1977
Joint Returns
Four Dependents

Expanded income class	1977 law tax			Treasury proposal			Change in tax liability		
	Amount	Percentage distribution	Average tax liability	Amount	Percentage distribution	Average tax liability	Amount	Average tax liability: Amount	Average tax liability: Percentage change from 1977 law
($000)	($ mil.)			($ mil.)			($ mil.)		
Less than 10	-31	-0.5	-64	-32	-0.6%	-66	-1	-2	-3.3%
10 - 15	295	5.0	526	65	1.3	117	-230	-409	-78.0
15 - 20	938	15.9	1,375	596	12.1	874	-342	-501	-36.5
20 - 30	1,604	27.3	2,590	1,325	26.8	2,140	-279	-450	-17.4
30 - 50	1,212	20.6	5,720	1,094	22.1	5,163	-118	-557	-9.7
50 - 100	959	16.3	16,529	886	17.9	15,271	-73	-1,258	-7.6
100 - 200	596	10.1	42,090	611	12.4	43,150	15	1,060	2.5
200 and over	313	5.3	127,755	394	8.0	160,816	81	33,061	25.9
Total	$5,886	100.0%	$ 2,237	$4,940	100.0%	$ 1,878	$-946	$ -359	-16.1%

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

Note: Details may not add to totals due to rounding.

Table does not include imputed corporate tax.

1977 law includes a $3,000 capital loss offset against ordinary income scheduled under present law to be effective beginning in 1978.

Comparison of 1977 Tax Liability and Proposed Tax Liability
Under Treasury Proposal of September 21, 1977
Joint Returns
Five or more Dependents

Expanded income class	1977 law tax: Amount	1977 law tax: Percentage distribution	1977 law tax: Average tax liability	Treasury proposal: Amount	Treasury proposal: Percentage distribution	Treasury proposal: Average tax liability	Change in tax liability: Amount	Change in tax liability: Average tax liability: Amount	Change in tax liability: Average tax liability: Percentage change from 1977 law
($000)	($ mil.)			($ mil.)			($ mil.)		
Less than 10	-28	-0.9	-77	-28	-1.1%	-77	--	--	--
10 - 15	129	4.0	258	6	0.2	11	-123	-247	-95.3%
15 - 20	349	10.7	1,000	155	5.9	445	-194	-555	-55.6
20 - 30	784	23.9	2,265	609	23.0	1,759	-175	-506	-22.3
30 - 50	649	19.8	5,192	573	21.6	4,584	-76	-608	-11.7
50 - 100	822	25.1	15,236	732	27.7	13,568	-90	-1,668	-10.9
100 - 200	344	10.5	37,189	351	13.3	37,946	7	757	2.0
200 and over	227	6.9	117,010	246	9.3	126,804	19	9,794	8.4
Total	$3,276	100.0%	$ 1,870	$2,647	100.0%	$ 1,511	$-629	$ -359	-19.2%

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

Note: Details may not add to totals due to rounding.

Table does not include imputed corporate tax.

1977 law includes a $3,000 capital loss offset against ordinary income scheduled under present law to be effective beginning in 1978.

Comparison of 1977 Tax Liability and Proposed Tax Liability
Under Treasury Proposal of September 21, 1977
Single Returns

Expanded income class	1977 law tax			Treasury proposal			Change in tax liability		
	Amount	Percentage distribution	Average tax liability	Amount	Percentage distribution	Average tax liability	Amount	Average tax liability: Amount	Average tax liability: Percentage change from 1977 law
($000)	($ mil.)			($ mil.)			($ mil.)		
Less than 10	6,081	26.7	217	5,019	23.7%	179	-1,062	-38	-17.5
10 - 15	6,091	26.7	1,595	5,789	27.3	1,516	-302	-79	-5.0
15 - 20	3,719	16.3	2,768	3,496	16.5	2,602	-223	-166	-6.0
20 - 30	2,422	10.6	4,236	2,264	10.7	3,960	-158	-276	-6.5
30 - 50	1,660	7.3	8,254	1,597	7.5	7,941	-63	-313	-3.8
50 - 100	1,306	5.7	18,465	1,389	6.6	19,638	83	1,173	6.4
100 - 200	713	3.1	42,015	748	3.5	44,078	35	2,063	4.9
200 and over	807	3.5	161,723	896	4.2	179,559	89	17,836	11.0
Total	$22,798	100.0%	$ 671	$21,197	100.0%	$ 623	$-1,601	$ -48	-7.0%

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

Note: Details may not add to totals due to rounding.

Table does not include imputed corporate tax.

1977 law includes a $3,000 capital loss offset against ordinary income scheduled under present law to be effective beginning in 1978.

Comparison of 1977 Tax Liability and Proposed Tax Liability
Under Treasury Proposal of September 21, 1977
Head-of-household and Married Filing Separate Returns

Expanded income class	1977 law tax			Treasury proposal			Change in tax liability		
								Average tax liability	
	Amount	Percentage distribution	Average tax liability	Amount	Percentage distribution	Average tax liability	Amount	Amount	Percentage change from 1977 law
($000)	($ mil.)			($ mil.)			($ mil.)		
Less than 10	1,170	18.9	211	697	13.0	126	-473	-85	-40.4
10 - 15	1,984	32.0	1,319	1,767	32.9	1,175	-217	-144	-10.9
15 - 20	1,097	17.7	2,293	1,002	18.7	2,094	-95	-199	-8.7
20 - 30	770	12.4	3,881	714	13.3	3,599	-56	-282	-7.3
30 - 50	420	6.8	7,657	404	7.5	7,366	-16	-291	-3.8
50 - 100	377	6.1	18,012	359	6.7	17,152	-18	-860	-4.8
100 - 200	128	2.1	38,323	146	2.7	43,713	18	5,390	14.1
200 and over	253	4.1	175,694	284	5.3	197,222	31	21,528	12.3
Total	$6,200	100.0%	$ 795	$5,371	100.0%	$ 688	$-829	$ -107	-13.4%

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

Note: Details may not add to totals due to rounding.

Table does not include imputed corporate tax.

1977 law includes a $3,000 capital loss offset against ordinary income scheduled under present law to be effective beginning in 1978.

Number of Returns and Comparison of 1977 Effective Tax Rates
and Treasury Proposal of September 21, 1977 Effective Tax Rates
Joint Returns
No Dependents

Expanded income class	Returns		Effective tax rates 1/	
	Number	Percentage distribution	1977 tax law	Treasury proposal
($000)	(thousands)	(.................	percent	.................)
Less than 10	6,061	34.9%	3.1%	1.6%
10 - 15	3,835	22.1	8.9	7.3
15 - 20	3,229	18.6	12.1	10.7
20 - 30	2,866	16.5	15.2	13.5
30 - 50	1,004	5.8	19.0	17.3
50 - 100	291	1.7	25.7	24.0
100 - 200	67	0.4	30.5	31.2
200 and over	20	0.1	33.5	35.7
Total	17,371	100.0%	14.3%	13.0%

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

Note: Details may not add to totals due to rounding.

Table does not include corporate tax.

1977 law includes a $3,000 capital loss offset against ordinary income scheduled under present law to be effective beginning in 1978.

1/ Tax liability as a percentage of expanded income.

Number of Returns and Comparison of 1977 Effective Tax Rates
and Treasury Proposal of September 21, 1977 Effective Tax Rates
Joint Returns
One Dependent

Expanded income class	Returns		Effective tax rates 1/	
	Number	Percentage distribution	1977 tax law	Treasury proposal
($000)	(thousands)	(.................	percent	.................)
Less than 10	2,489	25.9%	1.1%	-0.8%
10 - 15	2,432	25.3	8.1	5.8
15 - 20	2,057	21.4	11.1	9.3
20 - 30	1,859	19.4	14.2	12.6
30 - 50	584	6.1	18.4	16.3
50 - 100	145	1.5	25.8	23.4
100 - 200	29	0.3	32.4	31.1
200 and over	7	0.1	33.9	36.5
Total	9,602	100.0%	13.1%	11.3%

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

Note: Details may not add to totals due to rounding.

Table does not include corporate tax.

1977 law includes a $3,000 capital loss offset against ordinary income scheduled under present law to be effective beginning in 1978.

1/ Tax liability as a percentage of expanded income.

Number of Returns and Comparison of 1977 Effective Tax Rates
and Treasury Proposal of September 21, 1977 Effective Tax Rates
Joint Returns
Two Dependents

Expanded income class	Returns		Effective tax rates 1/	
	Number	Percentage distribution	1977 tax law	Treasury proposal
($000)	(thousands)	(..................	percent	..................)
Less than 10	1,733	18.3%	0.2%	-1.2%
10 - 15	2,316	24.5	6.9	3.9
15 - 20	2,306	24.4	10.0	7.8
20 - 30	2,172	23.0	13.1	11.3
30 - 50	696	7.4	17.3	15.2
50 - 100	192	2.0	24.9	22.3
100 - 200	32	0.3	31.8	30.3
200 and over	6	0.1	33.4	35.5
Total	9,453	100.0%	12.7%	10.7%

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

Note: Details may not add to totals due to rounding.

Table does not include corporate tax.

1977 law includes a $3,000 capital loss offset against ordinary income scheduled under present law to be effective beginning in 1978.

1/ Tax liability as a percentage of expanded income.

Number of Returns and Comparison of 1977 Effective Tax Rates
and Treasury Proposal of September 21, 1977 Effective Tax Rates
Joint Returns
Three Dependents

Expanded income class	Returns		Effective tax rates 1/	
	Number	Percentage distribution	1977 tax law	Treasury proposal
($000)	(thousands)	(..................	percent	..................)
Less than 10	940	17.5%	-0.7%	-1.2%
10 - 15	1,140	21.2	5.4	2.2
15 - 20	1,379	25.6	9.0	6.4
20 - 30	1,274	23.7	12.1	10.1
30 - 50	471	8.7	16.1	14.2
50 - 100	153	2.8	24.2	21.3
100 - 200	25	0.5	31.3	30.5
200 and over	5	0.1	33.4	36.8
Total	5,388	100.0%	12.6%	10.5%

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

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Table does not include corporate tax.

1977 law includes a $3,000 capital loss offset against ordinary income scheduled under present law to be effective beginning in 1978.

1/ Tax liability as a percentage of expanded income.

Number of Returns and Comparison of 1977 Effective Tax Rates
and Treasury Proposal of September 21, 1977 Effective Tax Rates
Joint Returns
Four Dependents

Expanded income class	Returns		Effective tax rates 1/	
	Number	Percentage distribution	1977 tax law	Treasury proposal
($000)	(thousands)	(.................	percent	.................)
Less than 10	482	18.3%	-1.0%	-1.0%
10 - 15	561	21.3	4.2	0.9
15 - 20	682	25.9	7.9	5.0
20 - 30	619	23.5	10.9	9.0
30 - 50	212	8.1	15.5	13.9
50 - 100	58	2.2	24.5	22.1
100 - 200	14	0.5	32.0	31.4
200 and over	2	0.1	32.1	35.7
Total	2,631	100.0%	11.5%	9.6%

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

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1977 law includes a $3,000 capital loss offset against ordinary income scheduled under present law to be effective beginning in 1978.

1/ Tax liability as a percentage of expanded income.

Number of Returns and Comparison of 1977 Effective Tax Rates
and Treasury Proposal of September 21, 1977 Effective Tax Rates
Joint Returns
Five or More Dependents

Expanded income class	Returns		Effective tax rates 1/	
	Number	Percentage distribution	1977 tax law	Treasury proposal
($000)	(thousands)	(..................	percent	..................)
Less than 10	365	20.9%	-1.2%	-1.1%
10 - 15	501	28.6	2.1	0.1
15 - 20	349	19.9	5.8	2.6
20 - 30	346	19.8	9.4	7.3
30 - 50	125	7.1	14.1	12.3
50 - 100	54	3.1	23.3	20.4
100 - 200	9	0.5	29.3	28.7
200 and over	2	0.1	28.1	28.3
Total	1,751	100.0%	9.9%	8.0%

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

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Table does not include corporate tax.

1977 law includes a $3,000 capital loss offset against ordinary income scheduled under present law to be effective beginning in 1978.

1/ Tax liability as a percentage of expanded income.

Number of Returns and Comparison of 1977 Effective Tax Rates
and Treasury Proposal of September 21, 1977 Effective Tax Rates
Single Returns

Expanded income class	Returns: Number	Returns: Percentage distribution	Effective tax rates 1/: 1977 tax law	Effective tax rates 1/: Treasury proposal
($000)	(thousands)	(.................	percent	.................)
Less than 10	27,972	82.3%	5.7%	4.7%
10 - 15	3,818	11.2	13.2	12.5
15 - 20	1,343	4.0	16.2	15.1
20 - 30	572	1.7	18.1	16.6
30 - 50	201	0.6	22.1	20.4
50 - 100	71	0.2	27.4	27.2
100 - 200	17	0.1	32.0	31.2
200 and over	5	*	35.2	35.1
Total	34,000	100.0%	11.1%	10.2%

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

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Table does not include corporate tax.

1977 law includes a $3,000 capital loss offset against ordinary income scheduled under present law to be effective beginning in 1978.

1/ Tax liability as a percentage of expanded income.

Number of Returns and Comparison of 1977 Effective Tax Rates
and Treasury Proposal of September 21, 1977 Effective Tax Rates
Head-of-household and Married Filing Separate Returns

Expanded income class	Returns		Effective tax rates 1/	
	Number	Percentage distribution	1977 tax law	Treasury proposal
($000)	(thousands)	(..................	percent	..................)
Less than 10	5,542	71.0%	4.0%	2.3%
10 - 15	1,504	19.3	10.9	9.7
15 - 20	479	6.1	13.6	12.4
20 - 30	198	2.5	16.5	15.1
30 - 50	55	0.7	20.9	19.5
50 - 100	21	0.3	27.4	25.0
100 - 200	3	*	28.4	29.9
200 and over	1	*	33.3	34.0
Total	7,803	100.0%	9.5%	8.2%

Office of the Secretary of the Treasury
Office of Tax Analysis

September 22, 1977

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Table does not include corporate tax.

1977 law includes a $3,000 capital loss offset against ordinary income scheduled under present law to be effective beginning in 1978.

1/ Tax liability as a percentage of expanded income.

*Less than .05 percent.